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# STOP: Tax Law Changes Ahead.

*Are You Ready?*

PRESENTED BY


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# Agenda

- Inflation Reduction Act of 2022
- Changes beginning in 2022 and 2023, such as:
  - Section 174 expenses;
  - Section 163(j) – Business Interest Expense Limitation; and
  - Section 168(k) – Bonus Depreciation
- Other Items

# Inflation Reduction Act of 2022

- Budget Reconciliation Process
  - Simple majority to pass
    - Avoids the 60-vote requirement to overcome a filibuster
  - May only include revenue and spending provisions
    - Byrd Rule
    - Decision made by Senate Parliamentarian
- Status Update
  - Passed by the Senate (51-50) and House (220-207) on August 7 and 12, respectively
  - President expected to sign on August 16

# Inflation Reduction Act of 2022 – Budget Estimates

- **Revenue ($737B)**
  - 15% Corporate Minimum Tax ($222B)
  - Prescription Drug Pricing Reform ($265B)
  - IRS Tax Enforcement ($124B)
  - 1% Stock Buyback Fee ($74B)
  - Loss Limitation Extension ($52B)
- **Investments ($437B)**
  - Energy Security & Climate Change ($369B)
  - Affordable Care Act Extension ($64B)
  - Western Drought Resiliency ($4B)

# Inflation Reduction Act of 2022 – Corporate Alternative Minimum Tax

- 15% minimum tax on adjusted financial statement income for Applicable Corporation
- Applicable Corporation – meets the Average Annual Adjusted F/S Income Test
  - Excludes: S Corporation, Regulated Investment Company and Real Estate Investment Trust
- Average Annual Adjusted F/S Income Test
  - U.S. companies – three-year average adjusted financial statement income greater than $1B
  - Aggregation rules apply and special rules for foreign-parented corporations
- Effective for taxable years beginning after December 31, 2022

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# Inflation Reduction Act of 2022 – Excise Tax on Repurchase of Corporate Stock

- Covered Corporation – subject to 1% excise tax on FMV of stock repurchased
- Covered Corporation – domestic corporation traded on established securities market
  - Defined in Reg. 1.7704-1(b)
- Repurchase – redemption or economically similar transaction
- Exceptions
  - Tax-free reorganizations under Sec. 368(a);
  - Repurchased stock contributed to employer-sponsored retirement plan, ESOP or similar plan;
  - Total value of repurchases does not exceed $1M;
  - Repurchases by RIC or REIT; and
  - Repurchase treated as a dividend
- Effective for repurchases after December 31, 2022

# Inflation Reduction Act of 2022 – Excess Business Loss Limitations

- Two-Year Extension of Excess Business Loss Limitations under Sec. 461(l)
- Effective Dates
  - As enacted by TCJA – taxable years beginning after 12/31/17 and before 1/1/26
  - COVID Modification – taxable years beginning after 12/31/20 and before 1/1/27
  - Inflation Reduction Act – taxable years beginning after 12/31/20 and before 1/1/29

- Summary
  - Applies to noncorporate taxpayers
  - Limits taxpayer's aggregate trade or business deductions to $500K (MFJ) or $250K (non-MFJ)
  - Disallowed amount treated as an NOL for subsequent tax years.

# Inflation Reduction Act of 2022 – Increased IRS Funding

- Enforcement
  - Intended to decrease the "Tax Gap"
- Taxpayer Services
  - Pre-filing assistance, filing and account services, and taxpayer advocacy services
- Operations Support
- Business System Modernization
  - Callback technology and other enhancements
  - Does not include maintenance of legacy systems
- IRS Run Free E-file System

## Polling Question #1

# Which, if any, of the revenue raisers in the Inflation Reduction Act are most likely to impact you or your business?

A. Corporate AMT
B. 1% Excise Tax on Corporate Stock Buybacks
C. Extension of the Excess Business Loss Limitation
D. Increase IRS Funding
E. None of the above

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# Inflation Reduction Act of 2022 – Tax Credits

- Electricity Produced from Renewable Resources
  - Extends credit for electricity produced from certain renewable resources through 2024
  - Increased credit available if taxpayer meets certain workforce and wage requirements in construction or operation of the facility
- Energy Investment Credit
  - Extended through 2024
  - Increased credit available for certain workforce and wage enhancements
  - Increased credit also available for solar facilities placed in service for low-income communities

# Inflation Reduction Act of 2022 – Tax Credits – cont.

- Residential Energy Incentives
  - Nonbusiness Energy Property Credits
    - Extended through 2032
    - Applies to:
      - Windows;
      - Doors;
      - Certain HVAC systems; and
      - Certain heat pumps
  - Residential Energy Efficient Property Credit
    - Extended through 2034
    - Renamed Clean Energy Credit

# Inflation Reduction Act of 2022 – Tax Credits – cont.

- Clean Vehicles (New Vehicles)
  - Purchase of clean vehicles including both plug-in electric and fuel cell
    - Sourcing requirements for the vehicle and battery systems
  - Extended through 2032
  - Maximum credit remains at $7,500
    - Limitations based on income and manufacturer's suggested retail price
- Clean Vehicles (Previously Owned Vehicles)
  - Available through 2032
  - Maximum credit: $4K
    - Income limitations apply

# Inflation Reduction Act of 2022 – Tax Credits – cont.

- Other Green Energy Credits
  - Credit for energy produced from zero-emissions nuclear power facility
  - Credit for sustainable aviation fuel sold or used after 2022
  - Credit for production of clean hydrogen after 2022
- Other Credits Extended and/or Modified
  - Carbon oxide sequestration credit modified and extended through 2032
  - Biodiesel, alternative fuel and alternative fuel mixtures modified and extended through 2024
  - Energy efficient commercial building deduction modified
  - New energy efficient homes credit modified and extended through 2032

# Inflation Reduction Act of 2022 – Items NOT Included

- Carried Interest Changes
- Extension of Enhanced Child and Earned Income Tax Credits
- Extension/Elimination of SALT Cap Deduction
- International Tax Provisions
- Income Tax Surcharge for Individuals
- Expansion of Net Investment Income Tax

## Polling Question #2

# Are you/your business currently taking advantage of any energy credits?

A. Yes, we have/are currently receiving some credits
B. No, we have in the past but not currently
C. No, we have never received any credits

# Research and Development (R&D) Tax Changes

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# Brief Overview of IRC Section 174 R&D Costs

- IRC 174 governs the treatment of R&D costs.
- 174(b): "research or experimental expenditures which are paid or incurred by the taxpayer during such taxable year in connection with the taxpayer's trade or business"
- Important note: 174 is <u>not</u> "qualified R&D" for purposes of the R&D tax credit. IRC 174 governs all R&D expenses/costs/expenditures, whether US or foreign, whether a credit was claimed or not, etc.

# Tax Cuts and Jobs Act (TCJA) Changes for R&D

- The TCJA changed the deductibility for R&D expenses. This change occurred when the TCJA was passed in late 2017, but did not take effect until tax years beginning after December 31, 2021.

## OLD LAW

*(2021 tax years and before):*

- R&D costs may be deducted as incurred.

## NEW LAW

*(2022 tax years and later):*

- R&D costs must be capitalized and amortized over the following periods:
  - U.S. R&D: 5 years
  - Foreign R&D: 15 years

# New R&D Tax Treatment

- New R&D costs (2022 and later) must be capitalized and can be amortized over five years for U.S. R&D, 15 years for foreign R&D. The amortization is straight line and does not follow MACRS.
- The "R&D tax asset" is deemed placed in service halfway through the year.
- This means in year one, only 10% of R&D costs are deductible. (20% deduction per year * asset placed in service halfway through year)

# New R&D Tax Treatment — cont.

- For a $1M U.S. based R&D expense incurred in 2022, the tax deductions would be as follows:
  - 2022: $100k
  - 2023-2026: $200k
  - 2027: $100k
- Any new R&D costs incurred in future years (such as 2023) would have to follow the same capitalize and amortize treatment

# Example Comparison

- Facts: Taxpayer has $750k of revenue and spends $1M on U.S. based R&D. No other revenue or expenses. Book loss of (250k).

## OLD LAW

*(2021 tax years and before):*

- Taxpayer takes $1M deduction in current year (2021) on $1M of R&D costs
- Taxable loss of (250k)

## NEW LAW

*(2022 tax years and later):*

- Taxpayer must capitalize U.S. based R&D and amortize over five years. Doing so results in unfavorable book/tax adjustment in 2022 of $900k
- Taxable income of 650k

# R&D Credit

- Taxpayers not only have an unfavorable addback for R&D (at least in initial years), but also must spend additional internal time to track R&D if they haven't been already. One way to recuperate some costs is the R&D tax credit, if qualified.
- The R&D tax credit can be around 4-7% of qualified R&D costs.
- Typically, R&D is qualified for the credit if a four-part test is met:
  - Must relate to a new or improved business component
  - Uses hard science, such as chemistry, engineering, computer science, etc.
  - Seek to eliminate uncertainty
  - Has a process of experimentation

## Polling Question #3

# Is your company taking advantage of the R&D tax credit?

A. Yes, we file a credit most years.
B. No, we have R&D but don't qualify for the credit.
C. No, we have no R&D or very small amounts.
D. I am unsure if we qualify or not, please reach out to me.

# 163(j) Interest Expense Limitation Changes

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# Brief Overview of IRC Section 163(j) Interest Expense

- 163(j) limits the deductibility of interest, generally subject to 30% of Adjusted Taxable Income (ATI), which is computed as taxable income plus or minus some adjustments.
- Some of the adjustments to ATI include business interest income, NOL deductions, and depreciation and amortization.

# Tax Cuts and Jobs Act (TCJA) Changes for Interest

- The TCJA changed the way ATI is calculated and removed the adjustment for depreciation and amortization, effective for tax years beginning after 12/31/2021 (2022 tax years).
- Adjusting for depreciation and amortization was taxpayer favorable, as it increased ATI and allowed a potentially higher interest expense deduction.
- Without this deduction, companies leveraged more with debt may find their interest deduction to be limited, even if it was not limited in previous years.

# Example Comparison

- Facts: Taxpayer has $1M of taxable income, which includes $500K of business interest expense, and $400K of depreciation.

### OLD LAW

*(2021 tax years and before):*

- Taxpayer ATI = $1.9M
  ($1M + 500K + 400K)
- Taxpayer interest expense limitation is 30% of ATI or $570k
- No interest limitation

### NEW LAW

*(2022 tax years and later):*

- Taxpayer ATI = $1.5M
  ($1M + 500k)
- Taxpayer interest expense limitation is 30% of ATI or $450k
- Disallowed/excess business interest expense of $50K

## Polling Question #4

# How much of an impact will the interest expense changes have on your business?

A. Large impact
B. Medium impact
C. Minimal or no impact
D. Unsure

# Bonus Depreciation Changes

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# Bonus Depreciation Phaseout

**The TCJA phases out bonus depreciation, under the following schedule based on the placed in-service date:**

| | |
|---|---|
| After September 27, 2017, and before January 1, 2023 | **100%** |
| 2023 Calendar Year | **80%** |
| 2024 Calendar Year | **60%** |
| 2025 Calendar Year | **40%** |
| 2026 Calendar Year | **20%** |
| 2027 and Subsequent | **0%** |

# Other Items

- Expiration of 100% deduction for business meal expenses provided by a restaurant (12/31/22)
- Employee Retention Credit Update
- Additional Reporting
  - Schedules K-2/K-3
  - Form 7203 (*S Corporation Shareholder Stock and Debt Basis Limitations)*

# Thank You!

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