#### August 17, 2022

# **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





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## 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**

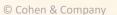
### Revenue (\$737B)

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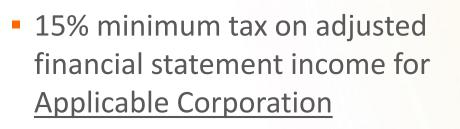
- 15% Corporate Minimum Tax (\$222B) >
- > Prescription Drug Pricing Reform (\$265B)
- IRS Tax Enforcement (\$124B)
- > 1% Stock Buyback Fee (\$74B)
- Loss Limitation Extension (\$52B)

### 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



 Applicable Corporation – meets the Average Annual Adjusted F/S Income Test

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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





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

- <u>Covered Corporation</u> subject to 1% excise tax on FMV of stock <u>repurchased</u>
- 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(I)
- 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

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- > 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





### 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.



- > 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**

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### 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







### 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



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### **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**

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(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

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- 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**

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### 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.

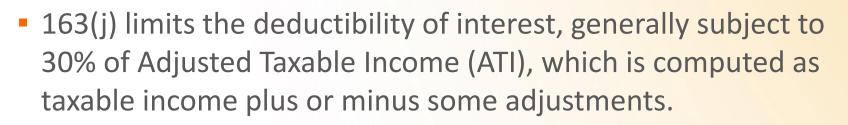


## **163(j) Interest Expense** Limitation Changes





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



 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**







### **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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