December 2022

Tax Talk

A quarterly publication of Bridges & Dunn-Rankin, LLP

Inside this issue:

Dear Clients and Friends,

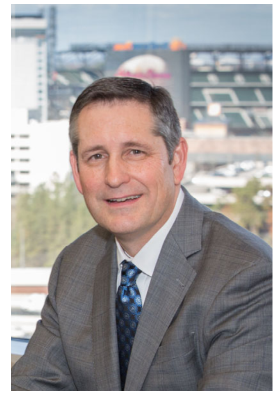
Another year has flown by. However, as a result of Hurricane Ian, tax-filing season for 2021 returns of residents of Florida, North Carolina and South Carolina has been extended to February 15, 2023; so "tax season" truly never ends.

We haven't had much recently in the way of significant Federal tax legislation (and, given the split power in Congress likely for the next couple of years, we don't anticipate much in the near term), but we will discuss in this issue the *Inflation Reduction Act* legislation enacted in August, as well as the IRS' ongoing war against syndicated conservation easements, tax planning with the "passthrough entity tax election", the employee retention credit, an unfortunate rule scheduled to take effect for 2022 for research expenditures, use of private foundation, donor advised fund or 501(c)(4), and our usual annual roundup of changes in amounts indexed to inflation.

We hope that you will enjoy this issue and gain from it some useful information.

Sincerely,

Kent Bridges



Kent Bridges,
Managing Partner

The Inflation Reduction Act

Congress has, in recent years, become increasingly creative in how it names legislation; particularly tax legislation. And so, the tax legislation enacted in August 2022 was named *The Inflation Reduction Act of 2022* (IRA), even though it does not appear to be designed to reduce inflation. Here is a high-level summary of what was included in the legislation.

Corporate alternative minimum tax (AMT) – For years beginning after 2022, C-corps with average net income over $1 billion will be subject to a tax equal to the excess of 15% of financial statement net income over AMT foreign tax credit.

Excise tax on repurchase of corporate stock – Repurchases of public-company stock after 2022 will be subject to a 1% tax.

Extension of limitation on excess business losses – TCJA enacted in late 2017 provided a new rule whereby the amount of business loss of an individual (as aggregated from all businesses) which could offset other sources of income was limited to $250,000 for singles and $500,000 for couples. Any amount in excess of this limitation becomes a net operating loss carryforward to the next year. Initially, the rule was to be applicable for years 2018 – 2025, but, as a part of Covid stimulus legislation, the rule was suspended for 2018 - 2020. IRA extends the rule through 2028 (such that the excess business loss limitation applies for losses incurred in 2021 – 2028).

Increase in R&D credit against payroll tax – For tax years beginning after 2022, the amount of research tax credit that a "qualified small business" (generally a business with gross receipts of less than $5,000,000 for the current year and no gross receipts in any year preceding the 5-taxable-year period ending with the current tax year) can claim as an offset against employer FICA is increased from $250,000 to $500,000.

Clean energy credits – The legislation extends, expands or provides for various tax credits associated with clean energy, and, for tax years beginning after 2022, permits the transfer of certain energy-related credits to another taxpayer. With respect to electric vehicles, the legislation extends the credit for purchases by individuals of new electric vehicles (but with income caps on who can qualify), and creates a new credit for purchases of used electric vehicles and purchases of commercial electric vehicles.

IRS funding – The legislation provides the IRS with $80 billion in new funding.

An Update on Conservation Easements

As mentioned in previous issues of this newsletter, Georgia has been the epicenter of the syndicated conservation easements industry, which has been in the IRS' crosshairs for quite some time. Accordingly, we continue to provide regular updates on the topic of conservation easements.

Although the IRS has not issued a broad-based settlement offer available to all taxpayers, it has continued to issue settlement offers for specific deals. In general, for those who were not involved in promoting the investment, the offer is that you forego the deduction you took and instead take deduction for amount of the investment, compute the tax on the difference, and pay that plus accrued interest and a penalty of 10%. Those who were involved in promoting the transaction get no deduction and pay the tax, accrued interest, and a penalty of 40%.

Taxpayers have scored a few wins recently.

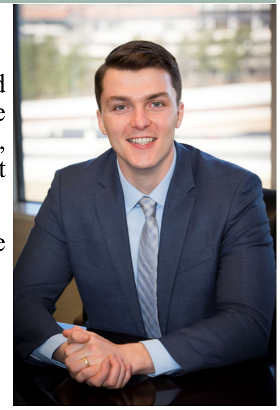
(Continued on page 2)

Member in the Spotlight — Shane McGrath

Bridges & Dunn-Rankin was fortunate to have Shane McGrath, a CPA with a BBA in Accounting and a Masters of Accountancy from The University of Georgia, join the firm in early 2022. Prior to joining BDR, Shane was in the Tax Department of the Big Four firm EY and also worked at Invisors as a Financial Accounting Software Consultant.

Shane is a member of the AICPA and the GSCPA. He and his wife, Sofia, reside in Virginia Highlands where they enjoy Piedmont Park and Virginia Highlands. They are also big fans of the University of Georgia Dawgs and Philadelphia Eagles. He and Sofia are active in Christ the King Catholic Church, and Shane recently completed his first marathon.

Bridges & Dunn-Rankin is proud to have Shane McGrath as a member of our firm.



Shane D. McGrath, CPA

An Update on Conservation Easements — continued

(Continued from page 1)

In October, in *Champions Retreat* (a case where the taxpayer appears to have had good facts and good legal representation), the Tax Court ruled that the taxpayer was entitled to a deduction of approximately $7.8 million (versus the $10.4 million the taxpayer had claimed and the $20,000 the IRS asserted). The 11th Circuit had previously ruled that the Tax Court erred in disallowing a conservation easement deduction solely because the property was a golf course.

Then, in November, *in Green Valley Investors*, the Tax Court ruled that the taxpayers were not subject to the penalty set forth in IRS Notice 2017-10 for failure to file Form 8886, because IRS failed to comply with the notice and comment rule of the Administrative Procedure Act when it issued the notice. Notice 2017-10 (issued in December 2016, but retroactive back to 2010) provided fairly draconian penalties (up to $100,000 for individuals and $200,000 for entities) for failure to report a syndicated conservation easement deduction on Form 8886; and the penalty applied even if the IRS never challenged the deduction itself. While the IRS has not agreed with the Tax Court ruling here, the ruling should provide some measure of comfort to those who may have inadvertently failed to file the form (which, in many cases, was not even a requirement at the time they took the deduction). Following the Tax Court's ruling, the IRS immediately issued proposed regulations which essentially set forth the same reporting requirements.

There have been proposals in Congress for quite some time to legislatively disallow conservation easement deductions in situations where the deduction claimed exceeds 2.5 times the amount paid. Past versions of the legislation (which would have applied retroactively back to 2016) have come close to passing, but failed. The current version in Congress, which seems more likely to pass, would be prospective only.

SALT Deduction Cap Workaround for Flow Through Entities

The *Tax Cuts and Jobs Act* enacted in late 2017 placed a $10,000 per year limit on individuals' deduction for state and local taxes (SALT) on Schedule A as itemized deductions. Many states with an individual income tax immediately began looking for workaround solutions to enable their residents to continue to receive a Federal income tax benefit for the state income tax paid.

To date, at least 27 states (including Georgia) have enacted or introduced legislation permitting S-corps and partnerships to elect (except in Connecticut where it is mandatory) an entity level tax in lieu of the income being taxed at the level of the individual owners. In Notice 2020-75, the IRS indicated that it would be issuing proposed regulations (not yet issued) under which such a tax would be deductible by the entity in computing its non-separately stated income or loss; effectively permitting a potential workaround to the $10,000 SALT deduction limitation at the individual level.

IRS Notice 2020-75 seems to leave open some important questions as to how the Federal deduction will work. For example, does the state tax actually have to be paid during the year in order to be deductible? Or can it be accrued by an accrual basis taxpayer? And how does the deduction apply with respect to an investment partnership, where the income giving rise to the state tax is portfolio income like interest, dividends and capital gain, rather than ordinary trade or business income? Forthcoming regulations will probably address these questions. In the meantime, taxpayers may have some latitude as to the positions they take.

The rules vary from state to state, but are generally somewhat similar to those enacted by Georgia. Effective for 2022, Georgia permits an eligible pass-through entity (an S-corp or a partnership 100% owned and controlled by persons who would be eligible to be S-corp shareholders) to elect (on timely filed return) to incur entity level tax in lieu of income flowing through to the owners. This is an annual election and, if made, the owners exclude from their Georgia taxable income the income which was subject to the entity level tax. If an entity intends to make the election, it should make quarterly estimated tax payments. Estimated payments made by the owners cannot be transferred to the entity. However, the entity can avoid incurring a penalty for underpayment of estimated tax by showing that the owners instead made personal estimated payments.

Under the rules of some states, rather than excluding from owner taxable income the income which was subject to entity level tax, the owner claims a credit on his or her personal tax return for their share of the tax paid at the entity level.

While it might seem a no-brainer to make the entity level tax election and gain the benefit of Federal deduction, it is actually a complicated decision. You have to consider whether the individual owner(s) have tax attributes or credits at their personal level that will go unutilized if you make the election, and how the state(s) of residence of the owner(s) will treat the K-1 income. This gets particularly complicated if you have a flow-through entity which is operating in multiple states and has owners who are resident in multiple different states.

Employee Retention Credit (ERC)

If you own a business, you have almost undoubtedly received emails, flyers and other solicitations suggesting that you can receive up to $26,000 per employee from the IRS; and the contingency fee consulting firm will help you get it for a percentage of the claim.

This may sound too good to be true. So, is it true? Well, it can be true; if you have the right set of facts and qualify under the rules.

As discussed in the June 2020 and April 2021 issues of our newsletter, Covid-stimulus legislation enacted in March 2020 and expanded in December 2020 provided for an "employee retention credit" (ERC) to reward employers who continued to pay employees during a time when the business was partially or fully suspended by government orders pertaining to Covid-19 or suffered a substantial decline in revenue during that time period.

As originally enacted in March 2020, the ERC was a maximum of $5,000 per employee (50% of qualified wages of up to $10,000 paid between March 12, 2020 and December 31, 2020). To be eligible, an employer's business had to be partially or fully suspended by orders from a governmental authority due to the Coronavirus or have had a 50% decline in revenue. For employers with 100 or fewer full-time employees (based on 2019 average), qualified wages included up to $10,000 per employee; regardless of whether they were able to work. For employers with more than 100 full-time employees, the amount was limited to being only those employees who were unable to work due to the shutdown. Employers accepting PPP funds were not eligible to claim the ERC. Since the PPP was, in general, more advantageous, the ERC was largely overlooked (except by those who were ineligible for PPP, such as 501(c)(7) organizations or companies with more than 500 employees).

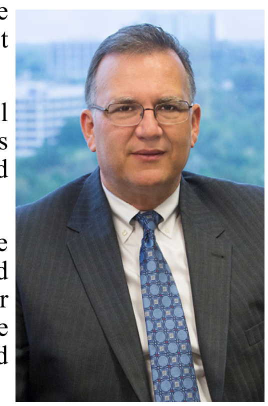
Legislation enacted in late 2020 (CAA 2021) changed the rules to provide that you could claim the ERC even if you accepted a PPP loan; just not for the same costs. The legislation extended the ERC through June 30, 2021 (later extended to 12/31/21 by subsequent legislation, and then later suspended for the 4th quarter of 2021), reduced the definition of substantial decline in revenue to 20% (beginning with Q4 2020 when compared to same quarter of 2019), increased the credit amount from 50% of qualified wages to 70% of qualified wages (effective 1/1/21), increased the limit on qualified wages (1/1/21) from $10,000 per employee in total to $10,000 per employee per quarter (with the wage limitation being based on amounts paid each specific individual, not by dividing total wages by number of employees), and increased to 500 the number of employees for small employer status. With these enhancements, the credit for 2020 and 2021 combined can potentially be as much as $26,000 per employee (and could have been as much as $33,000 per employee, had Congress not later suspended for the 4th quarter of 2021).

As discussed above, to be eligible for the ERC, the employer must have either suffered a substantial decline in revenue (originally defined as 50%, and later reduced to 20%) or have been subject to a government-mandated partial or full suspension of operations. The decline in revenue test is fairly mechanical. It is with the government-mandated partial or full suspension of operations where the action appears to be. IRS position is that to be eligible under this standard the suspension must be due to an order (not a suggestion or guidance) from a government with jurisdiction over the business, which limits commerce, travel or group meetings due to Covid-19, and results in a suspension of more than a nominal portion of the business (with "nominal" defined as being at least 10% of the revenue or employee service hours of the business).

The IRS, AICPA and many others have issued warnings that they believe some of the credit consulting firms are encouraging taxpayers who are not eligible under the standards to claim the ERC; and the IRS has announced that it is permitting anonymous reporting of potential ERC fraud claims. Some of the credit consulting firms appear to demand payment prior to the taxpayer receiving a refund. Further, even if the taxpayer does receive a refund check from the IRS, that does not mean the IRS has reviewed the claim for eligibility or accuracy; and the IRS can potentially come in many years later, examine the merits of the claim, disallow it, and seek recovery of the credit received plus penalties and interest thereon.

Our guess is that past ERC claims will attract scrutiny from due diligence teams in M&A transactions, capital raises and other situations for many years to come.

It should be noted that if you claim the ERC you are supposed to go back and amend income tax returns to reduce your deduction for wages for the amount of the ERC for the period the wages were paid which gave rise to the credit.



Kyle K. Bartleson, CPA

New Rule Requiring Capitalization and Amortization of R&D

Historically, "research and experimentation" expenditures have enjoyed very favorable tax treatment. You can elect to deduct such expenses immediately (or capitalize and amortize if more beneficial), the expenses are not subject to the general rules requiring capitalization of start-up expenses, and you can also receive Federal and state tax credits for the expenses.

In an effort to pay for the tax cuts included in the *Tax Cuts and Jobs Act* legislation enacted in late 2017, Congress included a provision that could be a ticking time bomb for early-stage technology companies. This provision, scheduled to take effect for 2022, requires that R&D expenses be capitalized and amortized over 5 years (15 years for research conducted outside the U.S.) rather than deducted immediately. This could result in a situation whereby taxable income (and the tax thereon) greatly exceeds net cash flow.

Legislation has been proposed (but not yet enacted), which would repeal or defer the capitalization rule. Hopefully, such legislation will be enacted and made retroactive. If not, companies may need to reconsider what they classify as R&D expenses versus normal ongoing operating expenses and whether the resulting R&D tax credit(s), if any, are sufficient to offset the tax on the additional income from capitalization.

Private Foundations, Donor Advised Funds, and 501(c)(4)s

For those who wish to get a charitable donations tax deduction today (e.g. potentially matching the deduction against a large gain from sale of their business), but wish to effectively control the money for a long period of time (perhaps even leaving a legacy for future generations to manage), a private foundation can work well. With a private foundation, you get a tax deduction when the money goes into the foundation, but are typically only required to distribute 5% of the value of the foundation's assets to charities each year. Also, you can gift appreciated securities to the foundation, and the foundation can sell the securities and incur only a fairly minimal level of tax on the gain (generally 1.39%).

One downside to private foundations, however, is that you must detail on the annual Form 990-PF each charitable distribution made, and 990-PFs are available to the public. However, if a private foundation makes a charitable distribution to a donor advised fund (DAF), only the name of the DAF appears on its 990-PF. The individual(s) who controls the private foundation can then make distributions to the ultimate charitable recipients without the names of such organizations being made publicly-available. A gift from the foundation to a DAF may also satisfy the 5% charitable distribution rule, while effectively delaying distribution to end-user charities.

Some people skip the step of setting up their own private foundation, and simply make charitable gifts directly to a DAF (which is another way of getting an upfront deduction while retaining some level of control, albeit not quite the level of control you have with your own private foundation). While the funds are under the control of the DAF, DAFs have a history of making charitable gifts from such funds at the direction of the donor.

For those who cannot use a large charitable tax deduction (e.g. they already have charitable deduction carryforwards due to the percentage of AGI limitations), formation of a 501(c)(4) organization (rather than a 501(c)(3) private foundation) may provide them a way to maintain family control over wealth or a large business holding without the limitations imposed on 501(c)(3) private foundations (e.g. prohibitions on "excess business holdings" and political lobbying); so long as the organization is "not organized for profit, but operated exclusively for the promotion of social welfare".

Quick Notes

- For 2023, the Social Security wage base increases to $160,200, the maximum wage base for computing retirement plan contributions increases to $330,000, the maximum benefit amount for a defined benefit plan increases to $265,000, the maximum amount which may be contributed to a defined contribution plan increases to $66,000, the maximum permissible elective 401(k) deferral increases to $22,500 ($30,000 for those age 50 and older), and the maximum permissible contribution to an IRA increases to $6,500 ($7,500 for those age 50 and older). Also, for 2023, the maximum amount which can be contributed to an HSA plan increases to $3,850 for individual coverage and $7,750 for family coverage. Those over age 55 can contribute an additional $1,000.
- The annual gift tax exclusion increases to $17,000 for 2023, and the lifetime estate and gift tax exclusion amount will increase to $12,920,000 (per spouse).
- The IRS business mileage rate for 2023 is 62.5 cents per mile.
- With the dramatic rise in short-term interest rates, the IRS interest rate on underpayments is now 7%.
- Subject to contingencies based on the state's revenue, the Georgia income tax rate (currently 5.75%) is scheduled to decline gradually (over the course of 2024 – 2029) to 4.99%. Beginning in 2022, unborn children can be claimed on Georgia returns as a dependent. Effective for 2024, the Georgia personal exemption amount will be increased and the standard deduction eliminated.
- For 2023 and beyond, Georgia will provide tax credits for donations to foster child support organizations and law enforcement foundations similar to those provided now for donations to provide private school scholarships and support rural hospitals.
- If you have opted into the IRS Identity Protection PIN program at any time in the past, the IRS should mail to you in December or January a new IP PIN for your 2022 income tax return. There is a separate IP PIN for each spouse who made the election. You must provide this number(s) to your tax return preparer. Otherwise, your returns will not go through electronically.

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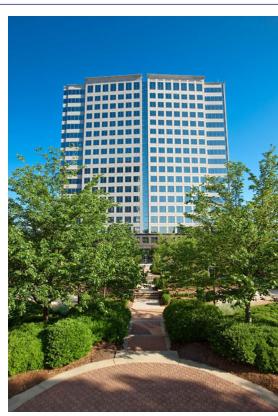

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