June 2023

Tax Talk

A quarterly publication of Bridges & Dunn-Rankin, LLP

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Dear Clients and Friends,

With a virtual stalemate in Congress, not much has happened recently in terms of Federal tax legislation. We had hoped that by now Congress would have acted to repeal that very unfortunate provision (which no one ever really expected to take effect) from the *Tax Cuts and Jobs Act* legislation of 2017 which requires companies (first effective for tax year 2022) to capitalize their R&D expenses and amortize such over 5 years (for R&D performed in the U.S.) or 15 years (for R&D performed outside the U.S.). But, to date, that has not happened.

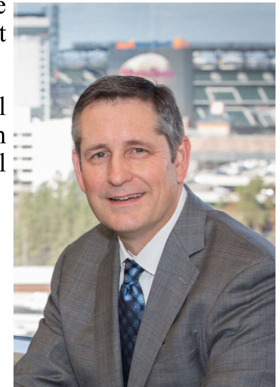
We have had some favorable Georgia tax legislation recently, which we will cover in this issue; and we briefly summarize some Federal tax legislation from late 2022.

With this being early June (a time when we scramble to make sure all of our clients are advised as to their required 2nd quarter estimated tax payments), we thought this would be an appropriate time to review quarterly estimated tax payment rules. Also, we discuss pre-sale charitable gifts of stock in privately-held businesses, electric vehicle credits and the IRS' most recent Dirty Dozen list.

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

Sincerely,

Kent Bridges



Kent Bridges, Managing Partner

Consolidated Appropriations Act of 2023

On December 29, 2022, President Biden signed into law the *Consolidated Appropriations Act of 2023*, which included retirement legislation known as *SECURE 2.0 Act*. While this legislation is mostly of interest to retirement plan administrators, there are a few provisions of more general interest which we summarize briefly here.

Increase in RMD age – Federal tax law has long provided "required minimum distribution" (RMD) rules, whereby you must begin taking distributions from your qualified retirement plans by a certain age (with the minimum annual amount based on a prescribed life expectancy table) or else be hit with a draconian penalty for failure to do so. For many years, the age at which the RMD rules kicked in was 70 ½. Legislation enacted in 2019 increased that age to 72. The new legislation further increases the RMD age to 73 (with a further scheduled increase to age 75 in 2033).

Reduction in the RMD penalty – The penalty for failure to take RMDs has historically been a draconian 50% of the shortfall amount. For 2023 and forward, the penalty has been reduced to 25%; and further reduced to only 10% if the shortfall is corrected within a timely manner.

Rollover of 529 to Roth – Beginning in 2024, unused amounts in a 529 plan (tax-favored college savings plan) can be rolled over tax-free to a Roth IRA; with significant restrictions. The 529 plan account must have been open at least 15 years; the rollover must be from the beneficiary of the 529 plan (not the account owner) to a Roth IRA held in the beneficiary's name; any contributions and earnings on those contributions made in the last five years are not eligible for the rollover; the total lifetime rollover amount must not be more than $35,000 for each beneficiary; and the rollover amount is subject to the annual Roth contribution limit (e.g. $6,500 for 2023).

Crackdown on syndicated 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. There have been proposals in Congress for years to legislatively disallow conservation easement deductions from partnerships 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) came close to passing, but failed. The version passed in late 2022 applies prospectively only (after December 29, 2022). Accordingly, for transactions entered into prior to late 2022, the fight over valuation and technical foot faults will likely continue to play out in the courts.

Quarterly Estimated Tax Payments

Quarterly estimated tax payments. Not exactly the sexiest of topics, but one we get a lot of questions about and one that creates a fire drill for our tax professionals the first two weeks of every January, April, June, and September.

Federal law requires that income tax be paid in at least quarterly over the course of the year. State rules vary, but are generally similar to (although often harsher than) the Federal rules, which we will summarize here.

Under Federal rules, you can avoid a penalty for underpayment of estimated tax (UET) by paying in each quarter at least the lesser of:

a) ¼ of 90% of your actual tax liability for the year (what we refer to as the "crystal ball method", since you are trying to forecast for the year, but the penalty is based on actual with

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Quarterly Estimated Tax Payments — continued

(Continued from page 1)

the benefit of hindsight);

b) ¼ of 100% (110% if your income was over $150,000) of your tax for the immediately preceding year (known as the "prior year tax liability safe harbor"); or

c) ¼ of your tax liability as computed by annualizing your actual taxable income year-to-date through the end of the month immediately preceding the payment date and computing the applicable tax thereon (known as the "annualized income installment method").

You can switch methods from quarter to quarter (going with the method which results in the least required amount); so long as you catch up cumulatively on the chosen method. You can pay any remaining balance due by April 15 of the following year, penalty free.

Withholding on W-2 is income is deemed to have occurred ratably throughout the year, unless you elect to prove otherwise.

The required payment dates for individuals are April 15, June 15, September 15 and January 15, for 1st, 2nd, 3rd and 4th quarters respectively. These dates, obviously, do not exactly align with the calendar quarters to which they relate (July 15 and October 15 would seem more logical dates for Q2 and Q3), and can result in some confusion and, occasionally, illogical results. For corporations, the required dates are the 4th, 6th, 9th and 12th months of the tax year (i.e., for a calendar year corporation, the same as that for individuals, other than Q4).

Unlike many tax penalties, the UET penalty is not a cliff. It is computed on a daily basis like interest, with the rate being tied to short-term interest rates (plus 3 percentage points, and with rounding, such that the current UET penalty rate is 7% per annum). So, there is no need to panic if you make your quarterly payment on the 16th (or 17th or 18th) rather than the 15th; as the penalty amount, if any, for being a few days late is likely to be relatively small. But lengthy delays in making the payments can obviously result in a meaningful penalty.

The penalty is computed on Form 2210 (2220 for corporations) when you file your income tax return for the year. When you file your return, the IRS system will first automatically check to see if you paid in each quarter at least 22.5% of your tax for the year. If so, no penalty applies. The IRS system will next check to see if you paid in each quarter at least 25% (27.5% if income was over $150,000) of your tax for the preceding year. If so, then no penalty applies. Absent meeting one of these two tests, you must attach Form 2210 (or 2220) to your return if you want to show that you avoid or minimize the penalty by computing your required payment based on the annualized income installment method. Similarly, you must attach Form 2210 if you want to show IRS that your W-2 withholding was frontloaded, rather than having been ratable throughout the year.

Because W-2 withholding is deemed to have occurred ratably throughout the year (unless you choose to show otherwise), having a significant amount of tax withheld on a late-year bonus can be a way to catch up and avoid a penalty for earlier quarters.

Large corporations (those with taxable income of $1,000,000 or more for any of the preceding 3 years), corporations for which the preceding year tax return was for less than 12 months, and corporations for which the preceding year return did not reflect a tax liability cannot rely on the prior year tax liability safe harbor.

It should be noted that under IRC 7203, criminal penalties can apply for a willful failure to pay estimated tax.

Georgia Expands PTET Election Eligibility

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. As we have discussed in past issues of this newsletter, in response, most states with an individual income tax (including Georgia) enacted legislation (typically referred to as "passthrough entity tax election" or "PTET election") permitting S-corps and partnerships to elect an entity level tax in lieu of the income being taxed at the level of the individual owners; thus providing a workaround to the $10,000 limit. The IRS effectively blessed this in Notice 2020-75.

Georgia's PTET election rules (first effective for 2022) initially provided that to be eligible for the election the entity had to be either an S-corp or a partnership 100% owned and controlled by persons eligible to be S-corp shareholders. Accordingly, partnerships and LLCs which had other entities as members were not eligible to make the election.

Legislation signed into law in May 2023 removes this ownership restriction, such that all passthrough entities are eligible to make the PTET election for tax years 2023 and forward.

Georgia Decouples from Federal Rule Requiring Capitalization of R&D

Historically, "research and experimentation" expenditures have enjoyed very favorable tax treatment. You could 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.

As discussed in previous issues of our newsletter, 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 (first effective for 2022) which 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. While Congress has not yet acted to repeal this very bad rule, thankfully the State of Georgia has enacted legislation "decoupling" from the Federal rule, whereby R&D expenses can be deducted immediately in computing Georgia taxable income.

Pre-Sale Charitable Gift of Stock of Privately-Held Business

Charitable gifts of cash can provide a nice tax benefit. Charitable gifts of appreciated assets can provide an even greater tax benefit, as you can potentially get a deduction for the value of the property and also have the appreciation forever escape tax.

This works great with publicly-traded stock, as the process is fairly clean, the value is readily available, and no appraisal is required under tax rules. Real estate can also work well, although an appraisal is required and there can be disputes with the IRS as to value. But what about stock or LLC units in a privately-held company just prior to its sale? Yes, that can work as well, but it is a bit more tricky.

First, S-corp stock generally does not work well, because income from an S-corp (including gain from sale of its stock) is considered unrelated business taxable income (UBTI) for the charitable organization. C-corp stock and LLC/partnership units can work, but you must complete the gift to charity prior to the sale transaction getting to the point that it is a virtual certainty that it will close; and you must get a qualified appraisal and have your Form 8283 signed by both the appraiser and the charitable organization.

In a recent case (*Hoensheid*), the Tax Court provided a thorough review of the rules applicable to a pre-sale charitable gift of appreciated stock in a privately-held company; and provided a road map of how <u>not</u> to do it.

Having entered into a letter of intent for the sale of the company he owned with his two brothers, Mr. Hoensheid wanted to make a significant gift of a portion of his share of the proceeds to a donor advised fund (Fidelity Charitable Gift Fund). Mr. Hoensheid recognized that there were significant income tax benefits to instead making a gift of some of his shares prior to the sale, but, according to an email he sent, did not want to do so until he was "99% sure" the sale transaction was going to happen. While he made the transfer of shares to Fidelity Charitable prior to closing, he did not do so until after several things had occurred which made it quite clear to the Tax Court that there was virtually no chance of the transaction not closing. Specifically, the Boards of both the selling company and the buyer had approved the transaction, they had swept all of the cash out of the company, and they had paid significant change of control bonuses out to employees. Under these circumstances, the Tax Court ruled that Mr. Hoensheid was taxable on the gain from sale of the gifted shares.

Although in the case of shares sold shortly after their receipt by a charitable organization it might seem that the value is obvious, tax law requires that in the case of a charitable gift in excess of $5,000 of something other than cash or publicly-traded stock, you must get a "qualified appraisal" (which can be done anytime from 60 days prior to the gift until the due date of the related income tax return). Typically, the appraiser will arrive at a value that is a little less than the ultimate sales price, because of the necessity to take into account the possibility that the transaction might not have closed. In the *Hoensheid* case, Mr. Hoensheid had the appraisal done by the investment banker which represented his company in the sale transaction (because he was willing to do it for no additional fee). While the investment banker may have been the most knowledgeable person as to the value of the company, the Tax Court found that he did not meet the definition of "qualified appraiser" and the report he issued did not meet the requirements for a "qualified appraisal". Accordingly, Mr. Hoensheid received no deduction for the charitable contribution.

Electric Vehicle Tax Credits

In a continued effort to promote the adoption of electric vehicles (EVs), recent updates to the tax code have expanded the existing tax credits while introducing new incentives. The *Inflation Reduction Act* extended the existing credit for the purchase of new electric vehicles, introduced a credit for purchasers of used EVs, and included a credit for the acquisition of commercial EVs. However, it's important to note that these changes come with income limitations for claiming the credits. Let's delve into the details of these updated tax incentives.

First and foremost, the tax credit for the purchase of a new electric vehicle has been extended. Under the *Inflation Reduction Act*, individuals can now claim a federal tax credit of up to $7,500, encouraging more people to transition to electric vehicles. However, it's worth noting that income limitations have been implemented. Individuals with an adjusted gross income (AGI) above $150,000 and joint filers with an AGI above $300,000 will no longer be eligible for the EV tax credit. There are also price limitations on vehicles that qualify for the tax credit. These limitations aim to focus the incentives on more affordable electric vehicles. For vans, SUVs, and pickup trucks, the tax credit is available for vehicles with a purchase price of up to $80,000. For other types of electric vehicles, including sedans and compact cars, the tax credit is available for vehicles with a purchase price of up to $55,000.

In addition to the extension of the new EV tax credit, the *Inflation Reduction Act* introduced a credit specifically for purchasers of used electric vehicles. For a purchase of a qualified used electric vehicle (EV) or fuel cell vehicle (FCV) from a licensed dealer for $25,000 or less, the credit equals 30% of the sale price, up to a maximum credit of $4,000. Similar to the credit for new EVs, income limitations also apply to the credit for used EVs.

Shane D. McGrath, CPA

Recognizing the importance of sustainable transportation in the commercial sector, the *Inflation Reduction Act* also introduced a tax credit for the purchase of commercial electric vehicles. Businesses and tax-exempt organizations that purchase a qualified commercial clean vehicle may qualify for a clean vehicle tax credit of up to $40,000. The credit amount is the lesser of: 1) 15% of the basis in the vehicle (30% if the vehicle is not powered by gas or diesel); or 2) the incremental cost of the vehicle. The maximum credit allowed is $7,500 for qualified vehicles with a gross vehicle weight rating (GVWR) under 14,000 pounds and $40,000 for all other vehicles.

For the credit for new or used EVs purchased by individuals, taxpayers should use IRS Form 8936. As for the commercial EV tax credit, additional guidance from the IRS is expected to outline the procedures for claiming the credit.

The IRS' Dirty Dozen List

Each year, the IRS publishes its "Dirty Dozen" list of 12 "common scams that taxpayers may encounter". For 2023, the IRS has warned about the following:

1. Aggressive promoters of potential refunds from Employee Retention Credit claims.
2. Phishing and smishing schemes using unsolicited emails and texts to solicit taxpayer information.
3. Scammers who offer to help you set up an IRS on-line account.
4. Promoters of false fuel tax credit claims.
5. Fake charities.
6. Unscrupulous tax return preparers.
7. Inaccurate or misleading tax advice circulated on social media.
8. Spearphishing attacks against tax professionals.
9. Offer in Compromise mills.
10. Promoter schemes involving charitable remainder annuity trusts and monetized installment sales.
11. "Bogus tax avoidance strategies", for which the IRS lists micro-captive insurance arrangements and syndicated conservation easements.
12. "Schemes with international elements", such as offshore accounts with digital assets, Maltese individual retirement arrangements misusing treaty, and Puerto Rican and foreign captive insurance.

Quick Notes

- Overruling the 5th Circuit, the Supreme Court has ruled that the $10,000 penalty for a non-willful failure to file an FBAR (foreign bank account report) applies on a per report basis, not a per account basis.
- The IRS has ruled (CCA 202302012) that in order to claim a deduction in excess of $5,000 for a charitable donation of cryptocurrency, you must have a qualified appraisal; even though the cryptocurrency is traded on an exchange.
- Cryptocurrency is not presently subject to the "wash sale rules", which disallow a loss from sale of a stock if you repurchase the same or substantially identical stock within 30 days. Congress may close this loophole.
- IRC 1221(b)(3) permits songwriters capital gains treatment for the sale of their musical catalogs. This has been quite beneficial for some high-profile musicians.
- For 2024, Georgia's standard deduction increases to $24,000 for married couples and $12,000 for singles, bringing these amounts more in line with the Federal amounts.
- The IRS has ruled (CCM AM 2022-007) that a contingency-fee law firm cannot defer taxation of its share of a settlement by entering into an arrangement for a third party to receive the payment, where the third party will make payment to the law firm in a future year.

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