SC&H GROUP

2023 Year-End Tax Planning

Mastering Tax Planning: A Comprehensive Guide to Individual, Business, and Corporate Taxes in 2024

Today's Agenda

1. Welcome & Introductions
2. Personal Tax Planning
3. Business Tax Planning
4. Corporate Tax Planning
5. Q&A and Wrap-Up

Personal Tax Planning

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Tax-Efficient Investing Strategies

Impact of Year-End Capital Gain Distributions

- **Asset Location Optimization:**
  - Allocate investments strategically across taxable and tax-advantaged accounts to maximize tax efficiency.
- **Tax-Loss Harvesting:**
  - Actively manage investment portfolios by selling securities that have experienced a loss to offset gains, reducing taxable income.
- **Tax-Efficient Investments:**
  - Consider tax-efficient investment vehicles, such as index funds and ETFs.

Optimizing Returns: Navigating Higher Yields

Plan Accordingly

1. What are you currently earning on cash?

2. Understand the tax impact of earning more interest.

3. Consider tax mitigation strategies.

Converting Excess 529 Funds to Roth IRAs

CONSIDERATIONS

- 529 account in existence for 15 years
- You have excess money remaining in the account
- Beneficiary has earned income

STRATEGY

- Transfer up to $7,000 annually from 529 to beneficiary's Roth IRA (or 100% of their earned income)
- Max total cumulative transfer of $35,000
- Certain states offer state tax deduction on contributions to 529 (incl. MD & VA)

Retirement Plan Considerations

Focusing on Small Business Owners & The Highly Compensated

1.

Solo 401(k)s

2.

Defined Benefit/Cash Balance Plans

Rules for Inherited IRAs

Required minimum distributions (RMDs) rules have been revised

- Effective 2023, RMD age is 73
- Only applies to IRA owners 73 and older and non-active 401(k) participants

Inherited IRA RMD rules have changed significantly for non-spouse

- The Secure Act removed stretch IRA options for non-spouse beneficiaries
- Certain inheritors, such as Trusts, may have to fully distribute the account within as little as 5 years

Individual Tax & Financial Planning

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Qualified Charitable Donations

QCD Basics

- Qualified charitable donation directly from an IRA account
- Taxpayers over 70.5 years of age are eligible
- Taxpayer never receives cash – Paid directly to charity
- Only applies to IRAs – Not 401(k) or 403(b) accounts
- Receive charitable donation deduction directly on 1040 without itemizing deductions
- Maximum amount allowed by IRS $100k per person

Qualified Charitable Donations

Advantages of QCDs

- Satisfies RMD requirements without increasing adjusted gross income and taxable income.
- IRA administrator pays donation directly to charity – No need for the taxpayer to cut a check to the charity.
- Allows contributions to multiple charities.
- Paying donations via QCD ensures that 100% of donation will be tax deductible.
- Keeping adjusted gross income lower can help avoid credit phase outs and could make less of the taxpayer's Social Security taxable.

Donations of Appreciated Stock

Planning and Considerations

- An option for taxpayers of any age
- The higher the unrealized gains, the more tax-efficient
- Must have owned the stock for at least one year
- More tax-efficient if you itemized deductions on your 1040
- No $ limitation – Overall limit is 30% of your AGI – Any amount in excess rolls forward
- Coordination between adviser and charity needed as shares go directly to the organization

Donations of Appreciated Stock

Example Scenario

- Taxpayer donates stock held 1 year or more - Basis of $10,000, FMV of $50,000
- Taxpayer doesn’t need to include $40,000 long-term Capital Gain in AGI
  - For most taxpayers, the tax on LTCG is between 15% and 23.8%
  - By avoiding Capital Gains tax, the taxpayer maximizes the ‘After Tax’ proceeds available to be donated
- Taxpayer also receives a charitable donation deduction of full $50,000 FMV of stock

Business Tax Planning

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General

- Limited tax law changes from 2022 to 2023
- Glidepath to 2025
- PTET and other "standard" strategies
- *"If it sounds too good to be true it probably is"*

Changes Compared to Last Year?

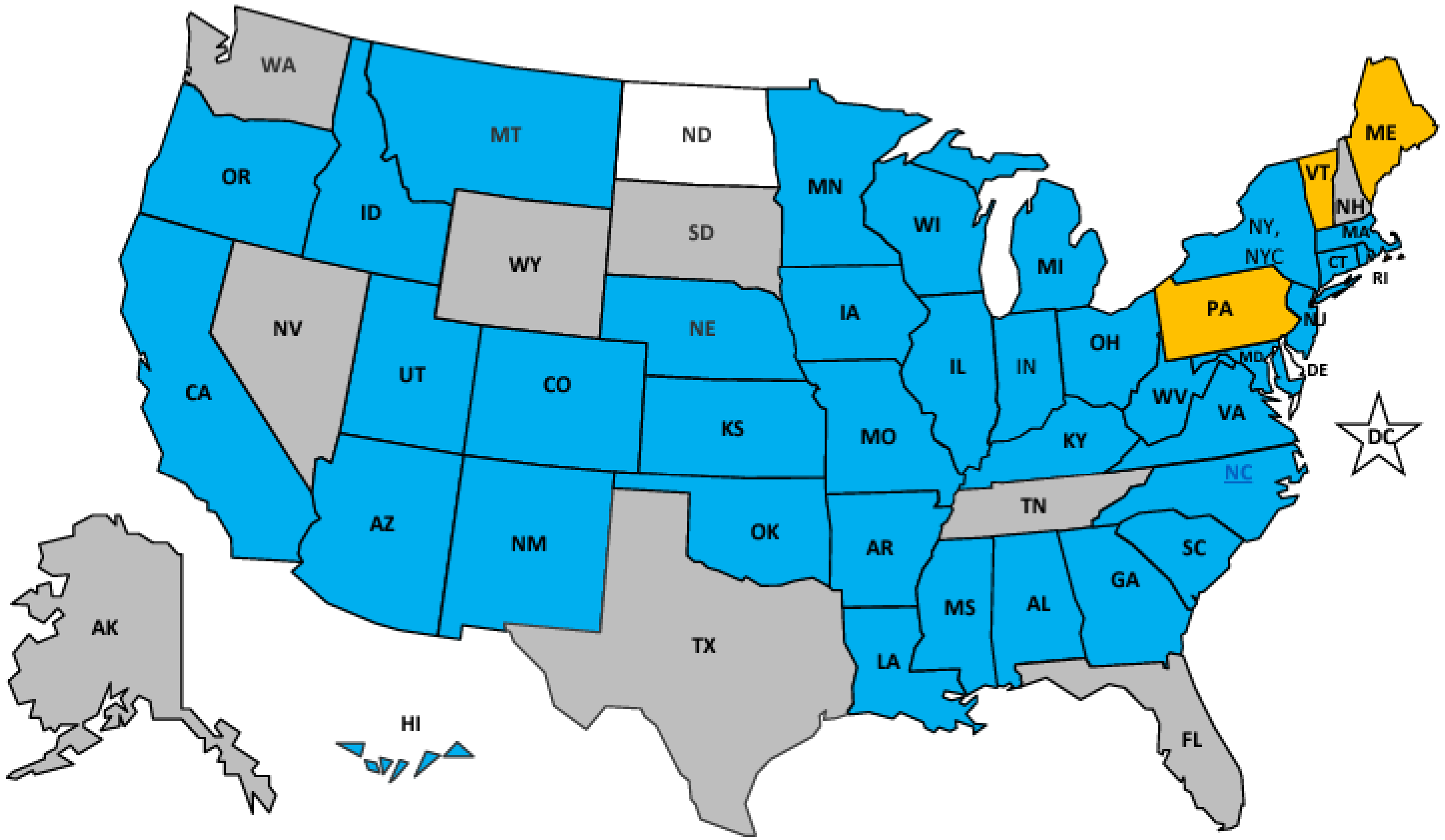
- No fundamental changes
- Bonus depreciation decreases to 80% of basis (acquisition cost) compared to 100% cost recovery in prior years
  - Decreases further to 60% recovery for tax year 2024
- Research & Development Expenditure must be capitalized
  - Last year we were hopeful that Congress would retroactively allow immediate deductions
  - No progress has been made – Working assumption is that R&D Expenditures must be capitalized

Glidepath to 2025

- Current tax law
  - Limited changes in tax years 2024 and 2025
  - Without any Congressional action the tax code will revert to 2017 tax law
- Will the PTET / SALT deduction go away
  - General feeling is that even if tax law reverts, PTET structures would be maintained by states
- What long term planning are we seeing for business owners
  - SLAT structures to maximize lifetime exemption

PTET / SALT Deduction at Entity Level

As of November 12, 2023



36 states (& 1 locality) that enacted a PTE tax since TCJA SALT deduction limitation, effective for 2021 (or earlier) unless noted:

AL, AR[1], AZ[1], CA, CO[3], CT[4], HI[2], GA[1], IA[1], ID, IL, IN[1], KS[1], KY[1] (& KY) ,LA, MA, MI, MD, MN, MO[1], MS[1], MT[2], NC[1], NE[3], NJ, NM[1], NY, OH[1], OK, OR[1], RI, SC, UT[1], VA, WI, WV[1], and NYC[1]

[1] Effective in 2022
[2] Effective in 2023 or later
[3] Retroactive to 2018
[4] Mandatory

3 states with proposed PTE tax bills:
ME - LD 1891 carried over to next session
PA – SB 659 referred to Finance
VT – SB45 passed Senate, failed in House

9 states with no owner-level personal income tax on PTE income:
AK, FL, NH, NV, SD, TN, TX, WA, WY

3 states with an owner-level personal income tax on PTE income that have not yet proposed or enacted PTE taxes:
DC, DE, and ND

AICPA

PTET / SALT Deduction at Entity Level

- Many / most states have such provisions
  - Great tool for smaller / local / family ownership groups
  - Tricky when owners live in other states
    - Some states do not give credit for PTET payments paid to other states
- Payments generally have to be made before year-end for current year deduction
  - Some ambiguity for accrual basis taxpayers
- Some states have 12/15 due dates
- Some states (ex: MD) have a non-revocable election

Non-Income Tax Considerations

MarylandSaves Program

- Retirement savings program for employees
- Required filing for entities created / registered in Maryland
- $300 Exemption available for certain employers

Corporate Transparency Act (CTA)

- Many entities required to report their beneficial ownership beginning 1/1/2024
- New entities created after 1/1/2024 must register within 30 days of creation
- Additional filing(s) may be required due to future ownership changes

If It Sounds Too Good to Be True, It Probably Is

Employee Retention Credit

- Per-employee credits available for certain periods in 2020 and 2021
- IRS first announced they would begin auditing many submissions
- IRS later announced a moratorium on submissions due to perceived fraud and abuse
- IRS released a process to rescind an application if taxpayers wish

Preventative Care Management Programs

- Purported to give both the company and employees a deduction for wellness expenses
- IRS has issued guidance on these plans 3 times, as far back as 2006
- Some ERC are now advertising these plans to Employers

Business Tax Planning

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Interest Expense

"Higher interest rates will equate to more interest expense!" - Captain Obvious

- 163(j) was amended by the Tax Cuts and Jobs act to limit the deduction for net business interest expense, in excess of interest income, to 30% of adjusted taxable income (ATI).

  a. ATI is now calculated as earnings before interest and taxes (EBIT), instead of earnings before interest, taxes, depreciation, and amortization (EBITDA).

  b. H.R. 3938: Build it in America Act would restore the ATI calculation to EBITDA. The bill is presently in House Committee, but per govtrack it only has a 34% chance of being enacted.

- Do you care? Sizeable interest expense, borrowing for capital / inventory, significant capital expenditures coming? You should care!

Interest Expense

There must be an exception…

- Bigs versus Smalls – Small business exception if gross receipts do not exceed $25 million under Sec. 448(c)! However, full stop if you are “tax shelter” or a “syndicate.”

- Exemptions and opt-outs – Are you an employee performing services? Farmer? Utility company? Opting out by making an election as a real property trade or business?

- Is it really interest?

  a. Inventory?

  b. Fixed asset?

  c. Other carried cost…

  d. Can’t reclassify it and don’t meet an exception, exemption and can’t opt out? Carry it forward!

Margin and Investment Interest

- Limited to "investment income" as defined as:

    a. Interest

    b. Dividends (not qualified dividends)

    c. Excess "net capital" gains resulting from the disposition of investment property (excluding 1231 long term capital gains)

Tax play, elect to treat qualified dividends as net capital gains. This move loses the favorable capital gains tax rate associated with qualified dividends but will release trapped interest expense.

Passive Activity?

- Are you passive? Passive only until you need to be active?

    1. Active, materially participating in operations on a regular, continuous, and substantial basis.
    2. Passive, the opposite!

    Passive losses can only be matched against other passive income and losses are suspended until the activity is completely disposed of.

    Can you switch it up? Yes, but do it right!

    Hardy, T.C. Memo 2017-16, Dr. Hardy was a sole practitioner with a minority interest in a surgery center. Dr. Hardy's CPA received K-1s for 2006 and 2007 classifying the income as nonpassive and subject to self-employment tax.

    Two years later, while preparing Dr. Hardy's 2008 tax return, the CPA learned that Dr. Hardy was not involved in the management of the surgery center, was not liable for its debts, and using a "checklist" determined Dr. Hardy was passive.

    However, instead of amending 2006 and 2007, open tax years, the CPA simply changed the reporting for 2008 and netted it against Dr. Hardy's previously suspended passive losses (tax planning!). However, the IRS challenged, and won, with the court determining that the losses needed to be deducted in the proper – still open – years.

Basis Limitations?

TAX BASIS

HYBRID BASIS

DEBT BASIS

GAAP BASIS

704(b) BASIS

- How much did you invest?
- How much money have you made and left in the business?
- How much money have you lost or taken as a distribution?
- How much are you on the hook for with creditors?

State Income Tax Nexus – Connect the Dots

- Registrations
- Inventory
- Employees
- Cost of Performance versus Market Based sourcing
  - Drop kick and drop ship
  - Sales to the Gov't
  - Sales tax indicator

SALY (same as last year) is really a poor choice and businesses can no longer afford not to pay attention to state income tax nexus.

Corporate Transparency Act– An Opaque Topic?

What companies will be required to report beneficial ownership information to FinCEN?

- Companies required to report are called ***reporting companies***. There are two types of reporting companies:
  - ***Domestic reporting companies*** are corporations, limited liability companies, and any other entities created by the filing of a document with a secretary of state or any similar office in the United States.
  - ***Foreign reporting companies*** are entities (including corporations and limited liability companies) formed under the law of a foreign country that have registered to do business in the United States by the filing of a document with a secretary of state or any similar office.
- There are 23 types of entities that are exempt from the reporting requirements

Exceptions, But Most Small Businesses Won’t Fit and the Penalties For Failure to Comply Are Steep!

1. Securities reporting issuers
2. Governmental Authorities
3. Banks
4. Credit Unions
5. Depository Institutions
6. Money service businesses
7. Brokers or dealers in securities
8. Securities exchange or clearing agencies
9. Other exchange Act registered entities
10. Investment companies or investment advisors
11. Venture capital fund advisers
12. Insurance companies
13. State-licensed insurance producers
14. Commodity Exchange Act registered entities
15. Accounting Firms (registered Sarbanes-Oxley Act)
16. Public Utilities
17. Financial market utilities
18. Pooled investment vehicles
19. Tax exempt entities
20. Entities assisting tax exempt entities
21. Large operating companies (more than 20 FTEs, $5 million in gross receipts, physical office in the U.S.)
22. Subsidiaries of certain exempt entities
23. Inactive entities (not foreign owned, not sent or received funds greater than $1,000, no assets)

The reporting requirements is effective January 1, 2024. FinCEN will begin accepting beneficial ownership reports on that date.

Initial Reports

Required by all companies that meet the definition of **reporting company** and are **not exempt** from that definition.

Existing Reporting Companies

Created or registered to do business in the United States before January 1, 2024. Reports due by **January 1, 2025**.

New Reporting Companies

Created or registered to do business in the United States before January 1, 2024. Reports due within **30 calendar days** of receiving actual or public notice that the creation of registration of the reporting company is effective.

Equity, Stock, or Voting Rights

Any interest classified as stock or anything similar, regardless whether is confers voting power or voting rights, and even if the interest is transferable. Examples include:
- Equity, stock, or similar instrument
- Preorganization certificated or subscription
- Transferable share of or voting trust certificate or certificate of deposit for, an equity security, interest in a joint venture, or certificate of interest in a business trust

Capital or Profit Interest

Any interest in the assets or profits of a company organized as an LLC, which is similar to stock in a corporation and sometimes referred to as a 'unit'

Convertible Instruments

Any instrument convertible into equity, stock, or voting rights or capital or profit interest, whether or not anything needs to be paid to exercise the conversion. The related items are also ownership interests.
- Any future on any convertible instrument
- Any warrant or right to purchase, sell, or subscribe to a share or interest in equity, stock or voting rights or capital or profit interest, even if such warrant or right is a debt.

Option or Privilege

Any put, call, straddle, or other option or privilege of buying or selling equity, stock, or voting rights, capital or profit interest, or convertible instruments, except if the option or privilege is created and held by others without the knowledge or involvement of the reporting company

Catch All

Any other instrument, contract, arrangement, understanding, relationship, or mechanism used to establish ownership.

Substantial Control

Senior Officer

Any individual holding the position or exercising the authority of a:

1. President
2. Chief Financial Officer (CFO)
3. General Counsel (GC)
4. Chief Executive Officer (CEO)
5. Chief Operating Officer (COO)

Or any other officer, regardless of official title, who performs a similar function as these officers

Appointment of Removal Authority

Any individual with the ability to appoint or remove any senior officer or a majority of the board of directors or similar body

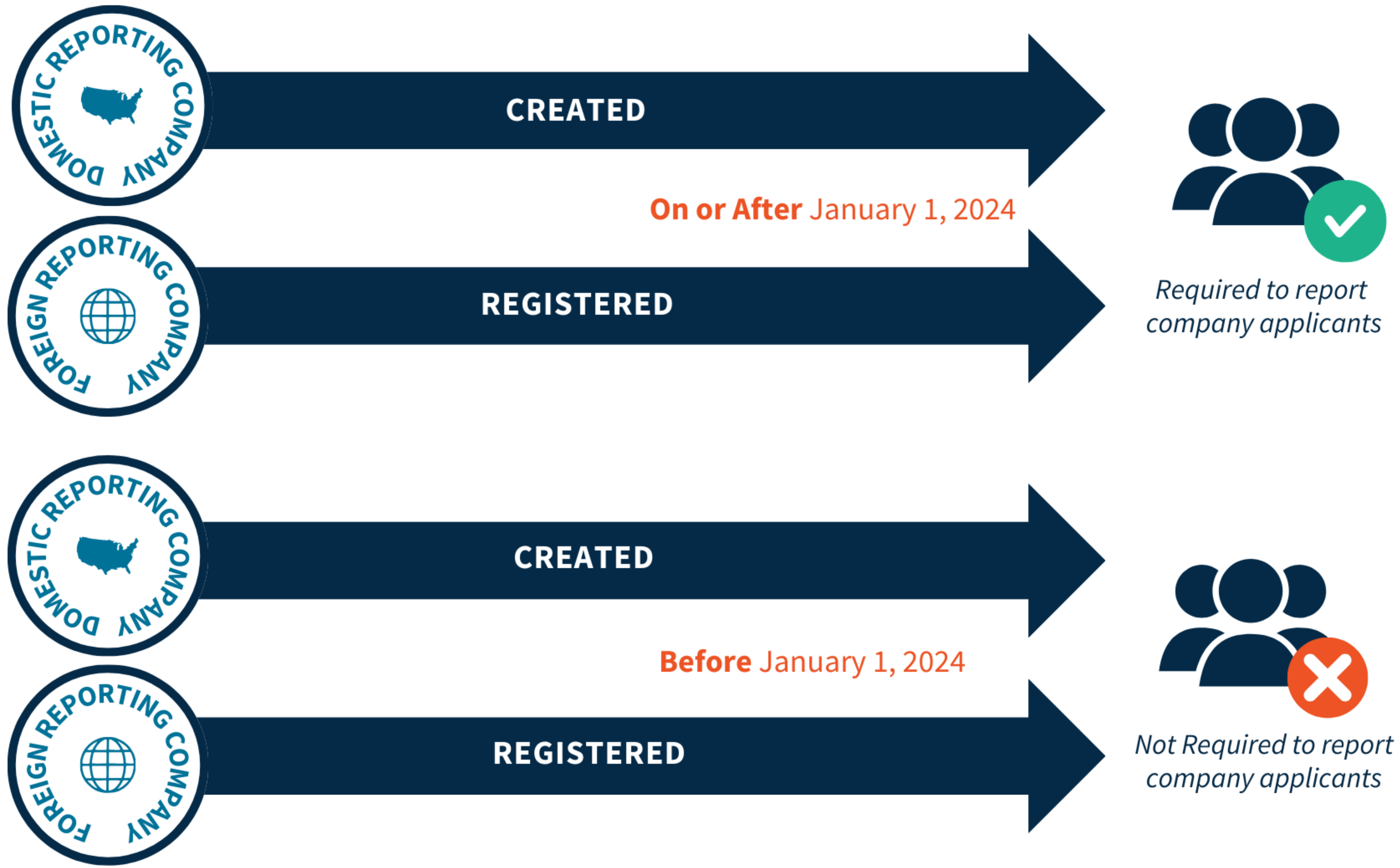
Important Decision-Maker

Any individual who directs, determines, or has substantial influence over important decisions made by the reporting company, including decisions regarding the reporting company's:

1. Business, such as:
    1. Nature, scope, and attributes of the business
    2. The selection or termination of business lines or ventures, or geographic focus
    3. The entry into or termination, or the fulfillment or non-fulfillment, or significant contracts
2. Finances, such as:
    1. Sales, lease, mortgage, or other transfer of any principal assets
    2. Major expenditures or investments, insurances of any equity, incurrence of any significant debt, or approval of the operating budget
    3. Compensation schemes and incentive programs for senior officers
3. Structure, such as:
    1. Reorganization, dissolution, or merger
    2. Amendments of any substantial governance documents of the reporting company, including the articles of incorporation or similar formation documents, bylaws, and significant policies or procedures

Catch All

Any other form of substantial control over the reporting company. Control exercised in new and unique ways can still be substantial. For example, flexible corporate structures may have different indicators of control than the indicators included here.


DOMESTIC REPORTING COMPANY
CREATED
On or After January 1, 2024
FOREIGN REPORTING COMPANY
REGISTERED
Required to report company applicants
DOMESTIC REPORTING COMPANY
CREATED
Before January 1, 2024
FOREIGN REPORTING COMPANY
REGISTERED
Not Required to report company applicants

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Federal Corporate Tax Updates

IRC §174 and R&D Tax Credit

- General definition of research or experimental expenditures
- Software development costs are specifically classified as R & E costs.
- Income tax treatment prior to January 1, 2022
- Capitalized and amortized (midpoint of tax year)
  - US research: 5 years
  - Non-US research 15 years

Federal Corporate Tax Updates

IRC §174 and R&D Tax Credit (continued)

- Starting point is R&D for financial reporting, but Section 174 is more expansive
- Current and deferred taxes impact
- Interplay with NOL and Section 163(j)
- 174 & R&D Tax Credit: Opposing interests – can I have one without the other?

Federal Corporate Tax Updates

NOL and IRC §382 Refresher

- Indefinite carryforward period – impact to valuation allowance analysis
  - "A cumulative loss in recent years is a significant piece of negative evidence that is difficult to overcome." - ASC 740-10-30-23
- NOL's before December 31, 2017 can offset 100% of federal taxable income. NOL's arising after December 31, 2017 can only offset 80% of income.
  - Separately track NOL years

Federal Corporate Tax Updates

NOL and IRC §382 Refresher (continued)

- What is the §382 limitation?
- §382 requires a corporation to limit the amount of income in future years that can be offset by historic NOL's once the corporation has undergone a significant stock ownership change within the testing period (generally a three-year period)
- Did an 'ownership change' occur? Analyzing the 5%-or-more shareholders
- Increased by more than 50 percentage points
- A shareholder's ownership percentage of stock determined by value, not number of shares

Federal Corporate Tax Updates

NOL and IRC §382 Refresher (continued)

- §382 limitation calculation:
    - The annual limitation amount is equal to the product of the federal long-term, tax-exempt interest rate (with some modifications) multiplied by the value of the old loss corporation (based on the value of its stock including preferred stock) immediately before the ownership change. – IRC § 382(b), (e), and (f).
- NUBIG and NUBIL

Federal Corporate Tax Updates

GILTI and FTC Update

- GILTI
  - Total active income earned by a US shareholders foreign affiliates that exceeds 10 percent of the company’s depreciable tangible property
  - Often gives rise to a Foreign Tax Credit
- IRS Notice 2023-55

Answering Your Questions

Disclaimer

This webinar contains general information about tax and legal matters. The information is for educational purposes and should be treated as such.

You may not rely on the information presented in this webinar as an alternative to legal or tax advice from an attorney or other professional.

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