

# 2022 Year-End Tax Planner



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# What's on Our Minds as 2022 Ends...



## Estate Planning

**Kim Spaulding, Shareholder**

The decline in our stock market presents an opportunity for taxpayers to consider converting their traditional IRAs to ROTHs using depressed values. ROTHs have an advantage over regular IRAs in that RMDs are not required during the lifetime of the account owner. Once converted, the account can grow tax-free and be an ideal asset to pass on to heirs if the funds are not needed during life. Of course, converting comes with an income tax cost that needs to be analyzed, but it also reduces the amount that may be subject to estate tax. If you anticipate lower income tax rates in the future or plan to donate the account to charity, this strategy likely won't be effective. For those taxpayers who would like to pass some of their wealth to charity, regular IRA accounts are an ideal asset to donate because they are otherwise subject to both income and estate tax at death, which can result in more than half of the account being consumed by tax.



## New FinCEN Reporting for U.S. and Foreign Companies Operating in the U.S.

**Yulia Sharapova-Leamy, Shareholder**

Tax and reporting compliance issues for U.S. taxpayers with foreign owners, foreign financial holdings, and foreign business activities have significantly increased in the past decade. The end of 2022 introduced yet another set of reporting requirements for U.S. and foreign companies operating in the U.S. The Treasury Department released the final rule that requires most privately held corporations, limited liability companies, and other entities created in or registered to do business in the United States to disclose information about their beneficial owners—people who own at least 25% of a company or exert significant authority over it—to Treasury's Financial Crimes Enforcement Network (FinCEN.)

This new disclosure requirement is mandated under the 2021 Corporate Transparency Act and aims to protect United States national security and strengthen the integrity and transparency of the U.S. financial system. The new rule takes effect January 1, 2024. There are several exceptions provided under the new rule for certain entities that are already subject to beneficial ownership disclosure requirements and certain large entities, including companies with 20 or more full-time employees in the U.S., more than \$5 million in sales inside the U.S., and an operating presence at a physical office within the U.S.

Many small U.S. businesses will most likely not qualify for the exception and will be mandated to file the report. Our international tax team is prepared to help our clients analyze the impact of this new reporting and identify information for the initial filing.



## New State Taxes Approaches

**Sonjia Barker, State and Local Tax Director**

We are continuing to see creativity with state taxes. Many states, including Washington, had their eye on Maryland when it adopted a digital advertising tax in 2021. Washington's tax on digital advertising did not pass out of legislative session in 2022, and the digital advertising tax was repealed in Maryland, but a different version of it could appear in Washington during the 2023-24 legislative session. Additional states may seek to tax digital products similar to Washington, as the state is leading a work group with the Multistate Tax Commission that will make recommendations to states to modernize their sales and use tax systems to include digital products.

Although Washington's Capital Gains Tax was ruled unconstitutional by the Superior Court, the Washington Department of Revenue moved ahead with drafting "advisory" rules as the case is heading to the Washington Supreme Court. The Department expects that a ruling will be made before the first Capital Gains Tax return would be due on April 18, 2023. Washington is also exploring replacing the business and occupation (B&O) tax with a margin tax similar to the Texas Franchise Tax, which will likely be proposed in the coming legislative session.

In addition to exploring new taxes to generate revenue, states have been ramping up their enforcement and audit activities for all types of taxes, including income taxes and sales and use taxes. States have become less forgiving about remote employees creating presence (nexus) and are reinterpreting the protections afforded under Public Law 86-272 for sellers of tangible personal property whose activity outside their home state is limited to solicitation of orders. Due to inflationary and supply concerns, many states are anticipating a reduction in sales tax revenue. Typically, when the economy is not doing as expected, states look to find revenue to conduct more sales tax audits.



## IRS Backlog Woes and 2022 Tax Need-to-Knows

**Kimberly Woodside, Shareholder**

Many taxpayers have experienced IRS delays in processing returns and issuing refunds. As of October 21, the IRS had roughly 3 million individual returns and 4 million business returns awaiting initial processing, plus another 2 million amended individual and business returns. Furthermore, they have another 250,000 unprocessed amended payroll tax returns, many the result of Employee Retention Tax Credit refund applications. The IRS currently estimates it will take at least 20 weeks to process your return. Recently, the IRS hired 4,000 customer service representatives to be trained to field taxpayers' questions during the 2023 tax season. However, that is to assist taxpayers, not process returns. And expect more audits (especially high-net-worth individuals, partnerships, and S corporations) starting in 2024/2025 once the IRS trains up its expanded workforce from its recent \$80 billion funding increase. Focus of these audits will include unreported income, undisclosed assets, basis limitations, and other tax avoidance schemes.

Some key things to consider for 2022:

- Place in service qualifying property before year end to claim 100% bonus depreciation, as this benefit will decrease 20% per year starting in 2023 until fully phased out.
- The deduction for meals purchased from a restaurant is 100% for 2022, reverting to 50% in 2023.
- The business interest expense limitation (163j) has changed in 2022—you are no longer allowed to add back the deductions for depreciation, amortization, and depletion in computing your allowable deduction. Explore making a real property trade or business (RPTOB) election if eligible to avoid this limitation.
- Selling or abandoning a worthless partnership interest before year-end to enhance tax benefits.



## Portland Tax Alignment Passed for City, County, and Metro

Sean Wallace, Shareholder

A long overdue simplification for our clients doing business in the Portland area is in the works.

Recently, the Portland City Council voted to adopt proposed changes for Portland, Multnomah County, and Metro taxing authorities to adopt the state's sales factor apportionment. These proposed adoptions will be effective for tax years starting on or after January 1, 2023. The adopted conformity will reduce differences and allows the jurisdictions to adopt and conform to the state's market-based sourcing of sales. The effect of this will reduce apportionment and allocation differences and ease the preparation of jurisdiction tax returns.

The proposed administrative rule changes can be found at the links below:

[Chapter 7.02 Proposed Administrative and Housekeeping Changes](#)

[191010 | Amend Business License Law Code related to the apportionment and allocation of income \(amend Code Chapter 7.02\)](#)

The proposed changes did not conform entirely to Oregon's apportionment factor—an important disconnect would still exist. Complete conformity to the state would require the adoption of the state's throwback provisions for the sale of tangible personal property (inventory). Throwback means assigning sales to the jurisdiction of origin when the sales are not taxable by the jurisdiction of the destination. This application could result in more sales (for apportionment purposes) being assigned to the jurisdictions. The proposed changes do not conform to the state's throwback provision, and, going forward, throwback would still not be required.

Businesses that perform services and sell non-tangible personal property will see the most significant changes to their city, county, and metro tax burdens, which will now more closely align with what income is being apportioned to Oregon.

Not only will the adopted changes reduce cumbersome alternative tracking of sales for local jurisdictions, but service providers who employ labor forces in the local markets should see a meaningful reduction of taxable income for those services performed for clients outside of the metropolitan area.

Furthermore, businesses from outside of the Portland region and outside of Oregon will now be required to apportion their income into the city/county/metro taxing authorities to more equitably raise tax revenue as a reflection of the greater economy where commerce is routinely conducted across jurisdictional boundaries.

Change is never easy, and it has been a constant in the tax environment these past few years. Perkins continues to evolve daily with the shifting landscape so that we can help you make the best decisions for your business. The new changes are in effect for the first quarter of the 2023 calendar year. Reach out to your Perkins team to help you plan for what's to come.



## 2022 Year-End Tax Planning for Individuals

With rising interest rates, inflation, and continuing market volatility, tax planning is as essential as ever for taxpayers looking to manage cash flow while paying the least amount of taxes possible over time.

As we approach year end, now is the time for individuals, business owners, and family offices to review their 2022 and 2023 tax situations and identify opportunities for reducing, deferring, or accelerating their tax obligations.

The information contained within this guide is based on federal laws and policies in effect as of the publication date. This article discusses tax planning for federal taxes. Applicable state and foreign taxes should also be considered. Taxpayers should consult with a trusted advisor when making tax and financial decisions regarding any of the items below.

## Individual Tax Planning Highlights

### 2022 Federal Income Tax Rate Brackets

| Tax Rate | Joint/Surviving Spouse | Single                | Head of Household     | Married Filing Separately | Estate & Trusts    |
|----------|------------------------|-----------------------|-----------------------|---------------------------|--------------------|
| 10%      | \$0 - \$20,550         | \$0 - \$10,275        | \$0 - \$14,650        | \$0 - \$10,275            | \$0 - \$2,650      |
| 12%      | \$20,551 - \$83,550    | \$10,276 - \$41,775   | \$14,651 - \$55,900   | \$10,276 - \$41,775       | -                  |
| 22%      | \$83,551 - \$178,150   | \$41,776 - \$89,075   | \$55,901 - \$89,050   | \$41,776 - \$89,075       | -                  |
| 24%      | \$178,151 - \$340,100  | \$89,076 - \$170,050  | \$89,051 - \$170,050  | \$89,076 - \$170,050      | \$2,751 - \$9,850  |
| 32%      | \$340,101 - \$431,900  | \$170,051 - \$215,950 | \$170,051 - \$215,950 | \$170,051 - \$215,950     | -                  |
| 35%      | \$431,901 - \$647,850  | \$215,951 - \$539,900 | \$215,951 - \$539,900 | \$215,951 - \$323,925     | \$9,851 - \$13,450 |
| 37%      | Over \$647,850         | Over \$539,900        | Over \$539,900        | Over \$323,925            | Over \$13,450      |

### 2023 Federal Income Tax Rate Brackets

| Tax Rate | Joint/Surviving Spouse | Single                | Head of Household     | Married Filing Separately | Estate & Trusts     |
|----------|------------------------|-----------------------|-----------------------|---------------------------|---------------------|
| 10%      | \$0 - \$22,000         | \$0 - \$11,000        | \$0 - \$15,700        | \$0 - \$11,000            | \$0 - \$2,900       |
| 12%      | \$22,001 - \$89,450    | \$11,001 - \$44,725   | \$15,701 - \$59,850   | \$11,001 - \$44,725       | -                   |
| 22%      | \$89,451 - \$190,750   | \$44,726 - \$95,375   | \$59,851 - \$95,350   | \$44,726 - \$95,375       | -                   |
| 24%      | \$190,751 - \$364,200  | \$95,376 - \$182,100  | \$95,351 - \$182,100  | \$95,376 - \$182,100      | \$2,901 - \$10,550  |
| 32%      | \$364,201 - \$462,500  | \$182,101 - \$231,250 | \$182,101 - \$231,250 | \$182,101 - \$231,250     | -                   |
| 35%      | \$462,501 - \$693,750  | \$231,251 - \$578,125 | \$231,251 - \$578,100 | \$231,251 - \$346,875     | \$10,551 - \$14,450 |
| 37%      | Over \$693,750         | Over \$578,125        | Over \$578,100        | Over \$346,875            | Over \$14,450       |

## Timing of Income & Deductions

Taxpayers should consider whether they can minimize their tax bills by shifting income or deductions between 2022 and 2023. Ideally, income should be received in the year with the lower marginal tax rate, and deductible expenses should be paid in the year with the higher marginal tax rate. If the marginal tax rate is the same in both years, deferring income from 2022 to 2023 will produce a one-year tax deferral, and accelerating deductions from 2023 to 2022 will lower the 2022 income tax liability.

Actions to consider that may result in a reduction or deferral of taxes include:

- Delaying closing capital gain transactions until after year end or structuring 2022 transactions as installment sales so that gain is deferred past 2022 (also see Long Term Capital Gains, below).
- Considering whether to trigger capital losses before the end of 2022 to offset 2022 capital gains.
- Delaying interest or dividend payments from closely held corporations to individual business-owner taxpayers.
- Deferring commission income by closing sales in early 2023 instead of late 2022.

- Accelerating deductions for expenses such as mortgage interest and charitable donations (including donations of appreciated property) into 2022 (subject to AGI limitations).
- Evaluating whether non-business bad debts are worthless by the end of 2022 and should be recognized as a short-term capital loss.
- Shifting investments to municipal bonds or investments that do not pay dividends to reduce taxable income in future years.

On the other hand, taxpayers that will be in a higher tax bracket in 2023 may want to consider potential ways to move taxable income from 2023 into 2022, such that the taxable income is taxed at a lower tax rate. Current year actions to consider that could reduce 2023 taxes include:

- Accelerating capital gains into 2022 or deferring capital losses until 2023.
- Electing out of the installment sale method for 2022 installment sales.
- Deferring deductions such as large charitable contributions to 2023.





## Long-Term Capital Gains

The long-term capital gains rates for 2022 and 2023 are shown below. The tax brackets refer to the taxpayer's taxable income. Capital gains also may be subject to the 3.8% Net Investment Income Tax.

### 2022 Long-Term Capital Gains Rate Brackets

| Tax Rate | Joint/Surviving Spouse | Single               | Head of Household    | Married Filing Separately | Estate & Trusts    |
|----------|------------------------|----------------------|----------------------|---------------------------|--------------------|
| 0%       | \$0 - \$83,350         | \$0 - \$41,675       | \$0 - \$55,800       | \$0 - \$41,675            | \$0 - \$2,800      |
| 15%      | \$83,351 - \$517,200   | \$41,676 - \$459,750 | \$55,801 - \$488,500 | \$41,676 - \$258,600      | \$2,801 - \$13,700 |
| 20%      | Over \$517,200         | Over \$459,750       | Over \$448,500       | Over \$258,600            | Over \$13,700      |

### 2023 Long-Term Capital Gains Rate Brackets

| Tax Rate | Joint/Surviving Spouse | Single               | Head of Household    | Married Filing Separately | Estate & Trusts    |
|----------|------------------------|----------------------|----------------------|---------------------------|--------------------|
| 0%       | \$0 - \$89,250         | \$0 - \$44,625       | \$0 - \$59,750       | \$0 - \$44,625            | \$0 - \$3,000      |
| 15%      | \$89,251 - \$553,850   | \$44,626 - \$492,300 | \$59,751 - \$523,050 | \$44,626 - \$276,900      | \$3,001 - \$14,650 |
| 20%      | Over \$553,850         | Over \$492,300       | Over \$523,050       | Over \$276,900            | Over \$14,650      |

Long-term capital gains (and qualified dividends) are subject to a lower tax rate than other types of income. Investors should consider the following when planning for capital gains:

- Holding capital assets for more than a year (more than three years for assets attributable to carried interests) so that the gain upon disposition qualifies for the lower long-term capital gains rate.
- Considering long-term deferral strategies for capital gains such as reinvesting capital gains into designated qualified opportunity zones.
- Investing in, and holding, "qualified small business stock" for at least five years.
- Donating appreciated property to a qualified charity to avoid long term capital gains tax (also see Charitable Contributions, below).

## Net Investment Income Tax

An additional 3.8% net investment income tax (NIIT) applies on net investment income above certain thresholds. Net investment income does not apply to income derived in the ordinary course of a trade or business in which the taxpayer materially participates. Similarly, gain on the disposition of trade or business assets attributable to an activity in which the taxpayer materially participates is not subject to the NIIT.

In conjunction with other tax planning strategies that are being implemented to reduce income tax or capital gains tax, impacted taxpayers may want to consider deferring net investment income for the year.

## Social Security Tax

The Old-Age, Survivors, and Disability Insurance (OASDI) program is funded by contributions from employees and employers through FICA tax. The FICA tax rate for both employees and employers is 6.2% of the employee's gross pay, but only on wages up to \$147,000 for 2022 and \$160,200 for 2023. Self-employed persons pay a similar tax, called SECA (or self-employment tax), based on 12.4% of the net income of their businesses.

Employers, employees, and self-employed persons also pay a tax for Medicare/Medicaid hospitalization insurance (HI), which is part of the FICA tax, but is not capped by the OASDI wage base. The HI payroll tax is 2.9%, which applies to earned income only. Self-employed persons pay the full amount, while employers and employees each pay 1.45%. An extra 0.9% Medicare (HI) payroll tax must be paid by individual taxpayers on earned income that is above certain adjusted gross income (AGI) thresholds, i.e., \$200,000 for individuals, \$250,000 for married couples filing jointly, and \$125,000 for married couples filing separately. However, employers do not pay this extra tax.



## Long-Term Care Insurance & Services

Premiums an individual pays on a qualified long-term care insurance policy are deductible as a medical expense. The maximum deduction amount is determined by an individual's age. The following table sets forth the deductible limits for 2022 and the estimated deductible limits for 2023 (the limitations are per person, not per return):

| Age                     | Deduction Limitation 2022 | Deduction Limitation 2023 |
|-------------------------|---------------------------|---------------------------|
| 40 or under             | \$450                     | \$480                     |
| Over 40 but not over 50 | \$850                     | \$890                     |
| Over 50 but not over 60 | \$1,690                   | \$1,790                   |
| Over 60 but not over 70 | \$4,510                   | \$4,770                   |
| Over 70                 | \$5,640                   | \$5,960                   |

## Retirement Plan Contributions

Individuals may want to maximize their annual contributions to qualified retirement plans and Individual Retirement Accounts (IRAs).

- The maximum amount of elective contributions that an employee can make in 2022 to a 401(k) or 403(b) plan is \$20,500 (\$27,000 if age 50 or over and the plan allows "catch up" contributions). For 2023, these limits are \$22,500 and \$30,000, respectively.
- The SECURE Act permits a penalty-free withdrawal of up to \$5,000 from traditional IRAs and qualified retirement plans for qualifying expenses related to the birth or adoption of a child after December 31, 2019. The \$5,000 distribution limit is per individual, so a married couple could each receive \$5,000.
- Under the SECURE Act, individuals are now able to contribute to their traditional IRAs in or after the year in which they turn 70½.
- The SECURE Act changes the age for required minimum distributions (RMDs) from tax-qualified retirement plans and IRAs from age 70½ to age 72 for individuals born on or after July 1, 1949. Generally, the first RMD for such individuals is due by April 1 of the year after the year in which they turn 72.
- Individuals age 70½ or older can donate up to \$100,000 to a qualified charity directly from a taxable IRA.
- The SECURE Act generally requires that designated beneficiaries of persons who died after December 31, 2019, take inherited plan benefits over a 10-year period. Eligible designated beneficiaries (i.e., surviving spouses, minor children of the plan participant, disabled and chronically ill beneficiaries, and beneficiaries who are less than 10 years younger than the plan participant) are not limited to the 10-year payout rule. Special rules apply to certain trusts.
- Under proposed Treasury Regulations (issued February 2022) that address required minimum distributions from inherited retirement plans of persons who died after December 31, 2019 and after their required beginning date, designated and non-designated beneficiaries will be required to take annual distributions, whether subject to a ten-year period or otherwise. This interpretation is at odds with the interpretation under the SECURE Act, in which annual distributions were not required when subject to full payout under the ten-year rule. If the proposed regulations are final before the end of 2022, there is some concern that annual distributions would be required for 2022 if the ten-year rule applies.



Beneficiaries can take a wait-and-see approach by calculating what those 2022 distributions would be, then wait to see if final Treasury Regulations are issued, before the end of 2022, that clarify the distribution requirement under the ten-year rule.

- Small businesses can contribute the lesser of (i) 25% of employees' salaries or (ii) an annual maximum set by the IRS each year to a Simplified Employee Pension (SEP) plan by the extended due date of the employer's federal income tax return for the year that the contribution is made. The maximum SEP contribution for 2022 is \$61,000. The maximum SEP contribution for 2023 is \$66,000. The calculation of the 25% limit for self-employed individuals is based on net self-employment income, which is calculated after the reduction in income from the SEP contribution (as well as for other things, such as self-employment taxes).

### Foreign Earned Income Exclusion

The foreign earned income exclusion is \$112,000 in 2022 and increases to \$120,000 in 2023.

### Alternative Minimum Tax

A taxpayer must pay either the regular income tax or the alternative minimum tax (AMT), whichever is higher. The established AMT exemption amounts

for 2022 are \$75,900 for unmarried individuals and individuals claiming head of household status, \$118,100 for married individuals filing jointly and surviving spouses, \$59,050 for married individuals filing separately, and \$26,500 for estates and trusts. The AMT exemption amounts for 2023 are \$81,300 for unmarried individuals and individuals claiming head of household status, \$126,500 for married individuals filing jointly and surviving spouses, \$63,250 for married individuals filing separately, and \$28,400 for estates and trusts.

### Kiddie Tax

The unearned income of a child is taxed at the parents' tax rates if those rates are higher than the child's tax rate.

### Limitation on Deductions of State & Local Taxes (SALT Limitation)

For individual taxpayers who itemize their deductions, the Tax Cuts and Jobs Act introduced a \$10,000 limit on deductions of state and local taxes paid during the year (\$5,000 for married individuals filing separately). The limitation applies to taxable years beginning on or after December 31, 2017 and before January 1, 2026. Various states have enacted new rules that allow owners of pass-through entities to avoid the SALT deduction limitation in certain cases.

## Charitable Contributions

Cash contributions made to qualifying charitable organizations, including donor advised funds, in 2022 and 2023 will be subject to a 60% AGI limitation. The limitations for cash contributions continue to be 30% of AGI for contributions to non-operating private foundations. Tax planning around charitable contributions may include:

- Maximizing 2022 cash charitable contributions to qualified charities to take advantage of the 100% AGI limitation.
- Creating and funding a private foundation, donor advised fund or charitable remainder trust.
- Donating appreciated property to a qualified charity to avoid long term capital gains tax.

## Estate & Gift Taxes

For gifts made in 2022, the gift tax annual exclusion is \$16,000 and for 2023 is \$17,000. For 2022, the unified estate and gift tax exemption and generation-skipping transfer tax exemption is \$12,060,000 per person. For 2023, the unified estate and gift tax exemption and generation-skipping transfer tax exemption is \$12,920,000. All outright gifts to a spouse who is a U.S. citizen are free of federal gift tax. However, for 2022 and 2023, only the first \$164,000 and \$175,000, respectively, of gifts to a non-U.S. citizen spouse is excluded from the total amount of taxable gifts for the year. Tax planning strategies may include:

- Making annual exclusion gifts.
- Making larger gifts to the next generation, either outright or in trust.
- Creating a Spousal Lifetime Access Trust (SLAT) or a Grantor Retained Annuity Trust (GRAT) or selling assets to an Intentionally Defective Grantor Trust (IDGT).

## Net Operating Losses & Excess Business Loss Limitation

Net operating losses (NOLs) generated in 2022 are limited to 80% of taxable income and are not permitted to be carried back. Any unused NOLs are carried forward subject to the 80% of taxable income limitation in carryforward years.

A non-corporate taxpayer may deduct net business losses of up to \$270,000 (\$540,000 for joint filers) in 2022. The limitation is \$289,000 (\$578,000 for joint filers) for 2023. A disallowed excess business loss (EBL) is treated as an NOL carryforward in the subsequent year, subject to the NOL rules. With the passage of the Inflation Reduction Act, the EBL limitation has been extended through the end of 2028.





## 2022 Year-End Tax Planning for Businesses

U.S. businesses are facing pressure to drive revenue, manage costs, and increase shareholder value, all while surrounded by economic and political uncertainties. Disruptions to supply chains brought about by the pandemic have continued into 2022. Inflation and rising interest rates have made the cost of debt, goods, and services more expensive and cooled consumer spending. The stock market has declined sharply, and the prospect of a recession is on the rise.

What's more, the outcomes of the November U.S. congressional elections—some of which as of this publication are still being tallied or heading to runoff—will shape future tax policies. How do businesses thrive in uncertain times?

By turning toward opportunity, which includes proactive tax planning. Tax planning is essential for U.S. businesses looking for ways to optimize cash flow while minimizing their total tax liability over the long term.

This article provides a checklist of areas where, with proper planning, businesses may be able to reduce or defer taxes over time. Unless otherwise noted, the information contained in this article is based on enacted tax laws and policies as of the publication date and is subject to change based on future legislative or tax policy changes.



## Recent Legislative Changes

### THE INFLATION REDUCTION ACT & THE CHIPS ACT

As the U.S. entered 2022, major proposed federal legislation that sought to raise taxes on large profitable corporations and high-income individuals (the Build Back Better Act) had died in the Senate. Although not nearly as broad in terms of tax increases, the Inflation Reduction Act (IRA) was enacted on August 16, 2022. Tax-related provisions in the IRA include:

- A 15% alternative minimum tax (AMT) on the adjusted financial statement income of certain large corporations (also referred to as the “book minimum tax” or “business minimum tax”), effective for tax years beginning after December 31, 2022.
- A 1% excise tax on corporate stock buybacks, which applies to repurchases made by public companies after December 31, 2022.
- Modification of many of the current energy-related tax credits and the introduction of significant new credits, including new monetization options.
- A two-year extension of the section 461(l) excess business loss limitation rules for noncorporate taxpayers, which are now set to expire for tax years beginning after 2028.

### CORPORATE AMT

The AMT is 15% of the adjusted financial statement income (AFSI) of an applicable corporation less the corporation’s AMT foreign tax credit. An applicable corporation is a corporation (other than an S corporation, a regulated investment company, or a real estate investment trust) whose average annual AFSI exceeds \$1 billion for the prior consecutive three years. The AMT can also apply to a foreign-parented multinational group that meets the \$1 billion AFSI test and whose net income in the U.S. equals or exceeds \$100 million on average over the same three-year period.

- Large corporations that may be subject to the AMT for 2023 will need to estimate their AFSI for tax years 2020, 2021, and 2022. Once a corporation is an applicable corporation, it remains an applicable corporation for all subsequent tax years.
- The rules for determining applicable corporations and calculating AFSI are complex and require Treasury to issue regulations and/or other guidance. When calculating AFSI, special aggregation rules apply to controlled groups and trades or businesses (including partnerships or a share of partnership income) under common control.
- Corporations that are subject to the AMT should be sure to consider the tax when making tax planning decisions.

## EXCISE TAX ON STOCK BUYBACKS

The 1% excise tax is imposed on U.S. public companies. The tax is 1% of the fair market value of any stock repurchased by a corporation during any taxable year ending after 2022, net of the fair market value of any new stock issued by the corporation during the taxable year. The IRA provides exceptions for certain repurchases (i.e., where the repurchased amount does not exceed \$1 million or where the repurchased amount is treated as a dividend for income tax purposes). The tax extends to certain affiliates of U.S. corporations, as well as specified affiliates of foreign corporations performing buybacks on behalf of their parent organization.

- Corporations planning taxable stock buybacks should consider executing repurchases by December 31, 2022 to avoid the 1% excise tax.

## TAX CREDITS

The IRA includes the largest-ever U.S. investment committed to combat climate change, providing energy security and clean energy programs over the next 10 years. Overall, the IRA modifies many of the current green energy credits and introduces significant new credits. Notably, the IRA also introduces new options for monetizing the credits, including the ability for taxable entities to elect a one-time transfer of all or a portion of certain tax credits to other taxpayers for cash.

The CHIPS Act, enacted on August 9, 2022, provides for a new 25% advanced manufacturing investment credit for investments in semiconductor manufacturing and for the manufacture of certain equipment required in the semiconductor manufacturing process.

For more information on the green energy credits and the advanced manufacturing investment credit, see Claim Available Tax Credits, below.





## Generate Cash Savings

### TAX ACCOUNTING METHOD CHANGES & STRATEGIC TAX ELECTIONS

Adopting or changing income tax accounting methods can provide taxpayers with valuable opportunities for timing the recognition of items of taxable income and expense, which determines when cash is needed to pay federal tax liabilities.

In general, accounting methods can either result in the acceleration or deferral of an item or items of taxable income or deductible expense, but they do not alter the total amount of income or expense that is recognized during the lifetime of a business. As interest rates continue to rise and debt becomes more expensive, many businesses want to preserve their cash, and one way to do this is to defer their tax liabilities through their choice of accounting methods.

Companies that want to reduce their 2022 tax liability should consider traditional tax accounting method changes, tax elections, and other actions for 2022 to defer recognizing income to a later taxable year and accelerate tax deductions to an earlier taxable year, including the following:

- Changing from recognizing certain advance payments (e.g., upfront payments for goods, services, gift cards, use of intellectual property, sale or license of software) in the year of receipt to recognizing a portion in the following taxable year.

- Changing from the overall accrual to the overall cash method of accounting (i.e., where accounts receivable exceed accounts payable and accrued expenses).
- Changing from capitalizing certain prepaid expenses (e.g., insurance premiums, warranty service contracts, taxes, government permits and licenses, software maintenance) to deducting when paid using the “12-month rule.”
- Deducting eligible accrued compensation liabilities (such as bonuses and severance payments) that are fixed and determinable by the end of the year and paid within 2.5 months of year end.
- Accelerating deductions of liabilities such as warranty costs, rebates, allowances and product returns, state income and franchise taxes, and real and personal property taxes under the “recurring item exception.”
- Purchasing qualifying property and equipment before the end of 2022 to take advantage of the 100% bonus depreciation provisions (before bonus depreciation begins to gradually phase out starting in 2023) and the Section 179 expensing rules.

## Tax Accounting Method Changes—Is a Form 3115 Required? And When?

Some of the opportunities listed above for changing the timing of income recognition and deductions require taxpayers to submit a request to change their method of tax accounting for the particular item of income or expense. Generally, tax accounting method change requests require taxpayers to file a [Form 3115, Application for Change in Accounting Method](#), with the IRS under one of the following two procedures:

- The “automatic” change procedure, which requires the taxpayer to attach the Form 3115 to the timely filed (including extensions) federal tax return for the year of change and to file a separate copy of the Form 3115 with the IRS no later than the filing date of that return; or
- The “nonautomatic” change procedure, which applies when a change is not listed as automatic and requires the Form 3115 (including a more robust discussion of the legal authorities than an automatic Form 3115 would include) to be filed with the IRS National Office during the year of change along with an IRS user fee. Calendar year taxpayers that want to make a nonautomatic change for the 2022 taxable year should be cognizant of the accelerated December 31, 2022 due date for filing Form 3115.

Tax accounting method changes generally allow for the recognition of unfavorable changes over four years while allowing the full amount of any favorable changes in the year of the change.

- Deducting “catch-up” depreciation (including bonus depreciation, if previously missed) of personal property by changing to shorter recovery periods or changing from non-depreciable to depreciable.
- Optimizing inventory valuation methods. For example, adopting, or making changes within, the last-in, first-out (LIFO) method of valuing inventory generally will result in higher cost of goods sold deductions as costs are increasing.
- Changing from amortizing commissions paid to employees to deducting in the year paid or incurred under the simplifying conventions.
- Electing to deduct 70% of success-based fees paid or incurred in 2022 in connection with certain acquisitive transactions under Rev. Proc. 2011-29. Other transaction costs that are not inherently facilitative may also be deductible. Taxpayers that incur transaction costs should consider undertaking a transaction cost study to maximize their tax deductions.
- Electing the de minimis safe harbor to deduct small-dollar expenses for the acquisition or production of property that would otherwise be capitalizable under general rules.

## IS “REVERSE” PLANNING BETTER FOR YOUR SITUATION?

Depending on their facts and circumstances, some businesses may instead want to accelerate taxable income into 2022 if, for example, they believe tax rates will increase in the near future or they want to optimize use of NOLs. These businesses may want to consider “reverse” planning strategies, such as :

- Implementing a variety of “reverse” tax accounting method changes, such as changing to recognize advance payments in the year of receipt or changing to deduct certain tax liabilities (state income, state franchise, real and personal property taxes, payroll taxes) when paid.
- Selling and leasing back appreciated property before the end of 2022, creating gain that is taxed currently offset by future deductions of lease expense, being careful that the transaction is not recharacterized as a financing transaction.
- Accelerating taxable capital gain into 2022.
- Electing out of the installment sale method for installment sales closing in 2022.
- Delaying payments of liabilities whose deduction is based on when the amount is paid, so that the payment is deductible in 2023 (e.g., paying year-end bonuses after the 2.5-month rule).

## TREATMENT OF R&E EXPENSES

Under the 2017 Tax Cuts and Jobs Act (TCJA), research and experimental (R&E) expenditures incurred or paid for tax years beginning after December 31, 2021 will no longer be immediately deductible for tax purposes. Instead, businesses are required to capitalize and amortize R&E expenditures over a period of five or 15 years beginning in 2022. The mandatory capitalization rules also apply to software development costs, including software developed for internal use. The new rules present additional considerations for businesses that invest in R&E.



## Write-Off Bad Debts & Worthless Stock

While the economy attempts to recover from the challenges brought on by the COVID-19 pandemic, inflation, and rising interest rates, businesses should evaluate whether losses may be claimed on their 2022 returns related to worthless assets such as receivables, property, 80% owned subsidiaries, or other investments.

- Business bad debts can be wholly or partially written off for tax purposes. A partial write-off requires a conforming reduction of the debt on the books of the taxpayer; a complete write-off requires demonstration that the debt is wholly uncollectible as of the end of the year.
- Losses related to worthless, damaged, or abandoned property can sometimes generate ordinary losses for specific assets.
- Businesses should consider claiming losses for investments in insolvent subsidiaries that are at least 80% owned and for certain investments in insolvent entities taxed as partnerships (also see Partnerships and S corporations, below).

## Maximize Interest Expense Deductions

The TCJA significantly expanded Section 163(j) to impose a limitation on business interest expense of many taxpayers, with exceptions for small businesses (those with three-year average annual gross receipts not exceeding \$27 million for 2022), electing real property trades or businesses, electing farming businesses, and certain utilities.

- The deduction limit is based on 30% of adjusted taxable income. The amount of interest expense that exceeds the limitation is carried over indefinitely.
- Beginning with 2022 taxable years, taxpayers will no longer be permitted to add back deductions for depreciation, amortization, and depletion in arriving at adjusted taxable income (the principal component of the limitation).

## Maximize Tax Benefits of NOLs

Net operating losses (NOLs) are valuable assets that can reduce taxes owed during profitable years, thus generating a positive cash flow impact for taxpayers. Businesses should make sure they maximize the tax benefits of their NOLs.

- For tax years beginning after 2020, NOL carryovers from tax years beginning after 2017 are limited to 80% of the excess of the corporation's taxable income over the corporation's NOL carryovers from tax years beginning before 2018 (which are not subject to this 80% limitation, but may be carried forward only 20 years). If the corporation does not have pre-2018 NOL carryovers, but does have post-2017 NOLs, the corporation's NOL deduction can only negate up to 80% of the 2022 taxable income with the remaining subject to the 21% federal corporate income tax rate. Corporations should monitor their taxable income and submit appropriate quarterly estimated tax payments to avoid underpayment penalties.
- Corporations should monitor their equity movements to avoid a Section 382 ownership change that could limit annual NOL deductions.
- Losses from pass-throughs entities must meet certain requirements to be deductible at the partner or S corporation owner level (also see Partnerships and S corporations, below).

## Defer Tax on Capital Gains

Tax planning for capital gains should consider not only current and future tax rates, but also the potential deferral period, short and long-term cash needs, possible alternative uses of funds, and other factors.

Noncorporate shareholders are eligible for exclusion of gain on dispositions of Qualified Small Business Stock. For other sales, businesses should consider potential long-term deferral strategies, including:

- Reinvesting capital gains in Qualified Opportunity Zones.
- Reinvesting proceeds from sales of real property in other "like-kind" real property.
- Selling shares of a privately held company to an Employee Stock Ownership Plan.
- Businesses engaging in reverse planning strategies (see Is "reverse" planning better for your situation? above) may instead want to move capital gain income into 2022 by accelerating transactions (if feasible) or, for installment sales, electing out of the installment method.



## Claim Available Tax Credits

The U.S. offers a variety of tax credits and other incentives to encourage employment and investment, often in targeted industries or areas such as innovation and technology, renewable energy, and low-income or distressed communities. Many states and localities also offer tax incentives. Businesses should make sure they are claiming all available tax credits.

- The Employee Retention Credit (ERC) is a refundable payroll tax credit for qualifying employers that were significantly impacted by COVID-19 in 2020 or 2021. For most employers, the compensation eligible for the credit had to be paid prior to October 1, 2021. However, the deadline for claiming the credit does not expire until the statute of limitations closes on Form 941. Therefore, employers generally have three years to claim the ERC for eligible quarters during 2020 and 2021 by filing an amended Form 941-X for the relevant quarter. Employers that received a Paycheck Protection Program (PPP) loan can claim the ERC but the same wages cannot be used for both programs.
- Businesses that incur expenses related to qualified research and development (R&D) activities are eligible for the federal R&D credit.
- Small business start-ups are permitted to use up to \$250,000 of their qualified R&D credits to offset the 6.2% employer portion of social security payroll tax. The IRA doubles this payroll tax offset limit to \$500,000, providing an additional \$250,000 that can be used to offset the 1.45% employer portion of Medicare payroll tax.
- Taxpayers that reinvest capital gains in Qualified Opportunity Zones may be able to temporarily defer the federal tax due on the capital gains. The investment must be made within a certain period after the disposition giving rise to the gain. Post-reinvestment appreciation is exempt from tax if the investment is held for at least 10 years but sold by December 31, 2047.
- The New Markets Tax Credit Program provides federally funded tax credits for approved investments in low-income communities that are made through certified "Community Development Entities."
- Other incentives for employers include the Work Opportunity Tax Credit, the Federal Empowerment Zone Credit, the Indian Employment Credit, and credits for paid family and medical leave (FMLA).

- There are several federal tax benefits available for investments to promote energy efficiency and sustainability initiatives. The IRA extends and enhances certain green energy credits as well as introduces a variety of new incentives. Projects that have historically been eligible for tax credits and that have been placed in service in 2022 may be eligible for credits at higher amounts. Additionally, projects that begin construction under the tax rules prior to 60 days after the Department of the Treasury releases guidance on these requirements are eligible for the credits at the higher rates. Certain other projects may be eligible for tax credits beginning in 2023. The IRA also introduces prevailing wage and apprenticeship requirements in the determination of certain credit amounts, as well as direct pay or transferability tax credit monetization options beginning with projects placed in service in 2023.
- Under the CHIPS Act, taxpayers that invest in semiconductor manufacturing or the manufacture of certain equipment required in the semiconductor manufacturing process may be entitled to a 25% advanced manufacturing investment credit beginning in 2023. The credit generally applies to qualified property placed in service after December 31, 2022 and for which construction begins before January 1, 2027. Where construction began prior to January 1, 2023, the credit applies only to the extent of the basis attributable to construction occurring after August 9, 2022.

## Partnerships & S Corporations

Partnerships, S corporations, and their owners may want to consider the following tax planning opportunities:

- Taxpayers with unused passive activity losses attributable to partnership or S corporation interests may want to consider disposing of the interest to utilize the loss in 2022.
- Taxpayers other than corporations may be entitled to a deduction of up to 20% of their qualified business income (within certain limitations based on the taxpayer's taxable income, whether the taxpayer is engaged in a service-type trade or business, the amount of W-2 wages paid by the business, and the unadjusted basis of certain property held by the business). Planning opportunities may be available to maximize this deduction.
- Certain tax basis, at-risk, and active participation requirements must be met for losses of pass-through entities to be deductible by a partner or S corporation shareholder. In addition, an individual's excess business losses are subject to overall limitations. There may be steps that pass-through owners can take before the end of 2022 to maximize their loss deductions. The Inflation Reduction Act extends the excess business loss limitation by two years (the limitation was scheduled to expire for taxable years beginning on or after January 1, 2027).
- Under current rules, the abandonment or worthlessness of a partnership interest may generate an ordinary deduction (instead of a capital loss) in cases where no partnership liabilities are allocated to the interest. If business conditions are such that the interest does not have value or the partner is considering abandonment, important issues need to be considered.
- Following enactment of the TCJA, deductibility of expenses incurred by investment funds are treated as "investment expenses"—and therefore are limited at the individual investor level— if the fund does not operate an active trade or business (i.e., if the fund's only activities are investment activities). To avoid the investment expense limitation, consideration should be given as to whether a particular fund's activities are so closely connected to the operations of its portfolio companies that the fund itself should be viewed as operating an active trade or business.
- Under current rules, gains allocated to carried interests in investment funds are treated as long-term capital gains only if the investment property has been held for more than three years. Investment funds should consider holding the property for more than three years prior to sale to qualify for reduced long-term capital gains rates.
- Various states have enacted PTE tax elections that seek a workaround to the federal personal income tax limitation on the deduction of state



taxes for individual owners of pass-through entities. See State pass-through entity tax elections, below.

- The transition rules in the 2019 final regulations that put an end to the use of bottom-dollar guarantees by partners to create recourse tax basis in a partnership will expire on October 4, 2023. Taxpayers that currently rely on the transition rules should review their partnership liability allocations.

## International Operations

Treasury issued final foreign tax credit (FTC) regulations on December 28, 2021 finalizing, with significant modifications, previously proposed regulations addressing the creditability standards for various foreign taxation amounts under the U.S. FTC system. The regulations modify long standing rules related primarily to withholding taxes on items such as royalties and services and add a standard related to a jurisdiction's transfer pricing rules needing to employ arm's length principles for in-country income taxes to be creditable.

The new standards primarily impact withholding and income taxes from certain Asian and Latin American countries. If your organization benefits from FTCs, now is the time to undertake a critical look at the jurisdictions you operate in and perform an assessment of whether taxes paid to such jurisdiction(s) are still available as FTCs.

In addition, the current economic environment has renewed the interest of many organizations to consider repatriating cash from overseas operations. Besides gaining access to cash, there could be significant U.S. tax advantages to repatriating those profits currently. If your organization has controlled foreign corporations (CFCs) and those CFCs have undistributed previously taxed earnings and profits (PTEP) from the Section 965 transition tax, Subpart F, and/or global intangible low taxed income (GILTI) from principally Euro or pound sterling functional currency entities, repatriating the PTEP could unlock deductions related to foreign exchange currency fluctuations.

For instance, if the Euro or pound sterling exchange rate has strengthened in favor of the U.S. dollar compared to when undistributed PTEP was generated, repatriating such PTEP now under current exchange rates will likely generate an ordinary deduction for the difference in the amount of U.S. dollars received now versus the amount that was previously included in income. Additionally, planning to mitigate foreign withholding taxes on distributions should be considered, and there may be strategies that can help achieve both objectives.



## Review Transfer Pricing Compliance

Businesses with international operations should review their cross-border transactions among affiliates for compliance with relevant country transfer pricing rules and documentation requirements. They should also ensure that actual intercompany transactions and prices are consistent with internal transfer pricing policies and intercompany agreements, as well as make sure the transactions are properly reflected in each party's books and records and year-end tax calculations. Businesses should be able to demonstrate to tax authorities that transactions are priced on an arm's-length basis and that the pricing is properly supported and documented. Penalties may be imposed for non-compliance.

Areas to consider include:

- Have changes in business models, supply chains, or profitability (including changes due to the effects of inflation) affected arm's length transfer pricing outcomes and support? These changes and their effects should be supported before year end and documented contemporaneously.
- Have all cross-border transactions been identified, priced, and properly documented, including transactions resulting from merger and acquisition activities (as well as internal reorganizations)?
- Do you know which entity owns intellectual property (IP), where it is located and who is benefitting from it? Businesses must evaluate their IP assets — both self-developed and acquired through transactions — to ensure compliance with local country transfer pricing rules and to optimize IP management strategies.
- If transfer pricing adjustments need to be made, they should be done before year end, and for any intercompany transactions involving the sale of tangible goods, coordinated with customs valuations.
- Multinational businesses should begin to monitor and model the potential effects of the agreement among OECD countries on a two pillar framework that addresses distribution of profits among countries and imposes a 15% global minimum tax.

## Considerations for Employers

Employers should consider the following issues as they close out 2022 and enter 2023:

- Employers have until the extended due date of their 2022 federal income tax return to retroactively establish a qualified retirement plan and to fund the new or an existing plan for 2022. However, employers cannot retroactively eliminate existing retirement plans (such as simplified employee pensions (SEPs) or SIMPLE plans) to make room for a retroactively adopted plan (such as an employee stock ownership plan (ESOP) or cash balance plan).
- Contributions made to a qualified retirement plan by the extended due date of the 2022 federal income tax return may be deductible for 2022; contributions made after this date are deductible for 2023.
- Employers can reimburse employees tax-free for up to \$5,250 per year in student loan debt, through Dec. 31, 2025, if the employer sets up a broad-based IRC Section 127 educational assistance plan.
- Employers seeking to attract and retain employees may offer tuition assistance to future employees by providing forgivable loan agreements. When the loans are forgiven (typically after the student has become an employee for a specified period of time), the amount forgiven is taxable wages, subject to income and employment taxes (including the employer share of employment taxes).
- The CARES Act permitted employers to defer payment of the employer portion of Social Security (6.2%) payroll tax liabilities that would have been due from March 27 through December 31, 2020. Employers are reminded that the remaining balance of the deferred amount must be paid by December 31, 2022. Notice CP256-V is not required to make the required payment.
- Employers should ensure that common fringe benefits are properly included in employees' and, if applicable, 2% S corporation shareholders' taxable wages. Partners and LLC members (including owners of capital interests and profits interests) should not be issued W-2s.
- Publicly traded corporations may not deduct compensation of "covered employees" — CEO, CFO, and generally the three next highest compensated executive officers — that exceeds \$1 million per year. Effective for taxable years beginning after December 31, 2026, the American Rescue Plan Act of 2021 expands covered employees to include five highest paid employees. Unlike the current rules, these five additional employees are not required to be officers.
- Generally, for calendar year accrual basis taxpayers, accrued bonuses must be fixed and determinable by year end and paid within 2.5 months of year end (by March 15, 2023) for the bonus to be deductible in 2022. However, the bonus compensation must be paid before the end of 2022 if it is paid by a Personal Service Corporation to an employee-owner, by an S corporation to any employee-shareholder, or by a C corporation to a direct or indirect majority owner.
- Businesses should assess the tax impacts of their mobile workforce. Potential impacts include the establishment of a corporate tax presence in the state or foreign country where the employee works; dual tax residency for the employee; additional taxable compensation for remote workers' travel to a work location that is determined to be personal commuting expense; and payroll tax, benefits, and transfer pricing issues.





## State & Local Taxes

Businesses should monitor the tax laws and policies in the states in which they do business to understand their tax obligations, identify ways to minimize their state tax liabilities, and eliminate any state tax exposure. The following are some of the state-specific areas taxpayers should consider when planning for their tax liabilities in 2022 and 2023:

### NEXUS RULES

- Has the business reviewed the nexus rules in every state in which it has property, employees, or sales to determine whether it has a tax obligation? State nexus rules are complex and vary by state. Even minimal or temporary physical presence within a state can create nexus, e.g., temporary visits by employees for business purposes; presence of independent contractors making sales or performing services, especially warranty repair services; presence of mobile or moveable property; or presence of inventory at a third-party warehouse. In addition, many states have adopted a bright-line factor-presence nexus threshold for income tax purposes (e.g., \$500,000 in sales). Also keep in mind that foreign entities that claim federal treaty protection are likely not protected from state income taxes, and those foreign entities that have nexus with a state may still be liable for state taxes.
- Has the business considered the state income tax nexus consequences of its mobile or remote workforce, including the impacts on payroll factor and sales factor sourcing? Most states that provided temporary nexus and/or withholding relief relating to teleworking employees lifted those orders during 2021. (Also see Considerations for employers, above.)
- Does the business qualify for P.L. 86-272 protection with respect to its activities in a state? For businesses selling remotely and that have claimed P.L. 86-272 protection from state income taxes in the past, how is the business responding to changing state interpretations of those protections with respect to businesses engaged in internet-based activities?

### FILING METHODS & ELECTIONS

- Is the business using the most advantageous filing method allowed by a state based on its facts and circumstances? States may require or allow a taxpayer to report on a separate company or unitary combined reporting basis, or may provide filing option elections. A state's mandatory unitary combined filing may allow a "water's edge" election or a worldwide combined group election. States have different rules for how and when to file water's edge and other reporting method elections; therefore, care should be taken that the election is filed on a timely basis.



- Where the taxpayer or a U.S. affiliate has foreign activities, or where the taxpayer has foreign affiliates, have the overseas business operations been evaluated as to whether they should be included in any water's edge unitary combined group?
- If the business's affiliated group has both loss entities and profitable entities, has the business considered making nexus consolidated return elections in states where such elections are allowed?
- Did the business make an S corporation election for federal income tax purposes, and is it required to make a separate state election (or file nonresident shareholder consents with the tax jurisdiction)?
- Does the business operate using single member LLCs or other federal disregarded entity structures, and has the tax treatment of those structures been reviewed for state-specific rules and filing requirements?

#### **TAXABLE INCOME & TAX CALCULATION**

- Does the state conform to federal tax rules or decouple from them? Not all states follow federal tax rules. For example, many states have their own systems of depreciation, and may or may not allow federal bonus depreciation.
- Where the business receives deductible dividends, GILTI, subpart F income, or other nontaxable income, have state expense disallowance attribution rules been applied?
- Does the business have intercompany royalty or other intangible expense, interest expense, or management fees paid to a related entity that may be required to be added back in computing state taxable income?
- Has the business claimed all state NOL and state tax credit carrybacks and carryforwards? Most states apply their own NOL/credit computation and carryback/forward provisions.
- Is the business claiming all available state and local tax credits? States offer various incentive credits including, e.g., for research activities, expanding or relocating operations, making capital investments, or increasing headcount.

#### **ALLOCATION & APPORTIONMENT**

- Is the business correctly sourcing its sales of tangible personal property, services, and intangibles to the proper states? The majority of states impose single-sales factor apportionment formulas and require market-based sourcing for sales of services and licenses/sales of intangibles using disparate market-based sourcing methodologies.
- Has the business considered whether a nonbusiness or allocable income position may be appropriate and whether taking such a position would be advantageous?
- If the business holds an interest in a partnership, have the consequences with respect to factor flow-through and other potential special partnership apportionment provisions been considered?
- If the taxpayer sold assets or a business segment, including where an IRC Section 336, 338(g), or 338(h)(10) election was made, has the multistate treatment of the sale gain receipts been addressed, including with respect to goodwill?
- If the business is a manufacturer, retailer, transportation company, financial corporation, or other special industry, have state special apportionment elections or required special apportionment formulas been considered?

#### **OTHER ISSUES**

- Has the business considered the state and local tax treatment of merger, acquisition, and disposition transactions? Keep in mind that internal reorganizations of existing structures also have state tax impacts. There are many state-specific considerations when analyzing the tax effects of transactions.
- Has the business considered state and local transfer pricing requirements with respect to its intercompany financing and other intercompany arrangements? With rising interest rates and inflation, intercompany arrangements should be re-addressed, and intercompany transfer pricing studies may need to be updated. Also see Transfer Pricing, above.



- Has the business amended any federal returns or settled an IRS audit? Businesses should make sure state amended returns are filed on a timely basis to report the federal changes. If a federal amended return is filed, amended state returns may still be required even when there is no change to state taxable income or deductions.

#### **STATE PASS-THROUGH ENTITY ELECTIONS**

The TCJA introduced a \$10,000 limit for individuals with respect to federal itemized deductions for state and local taxes paid during the year (\$5,000 for married individuals filing separately). Nearly 30 states have enacted workarounds to this deduction limitation for owners of pass-through entities, by allowing a pass-through entity to make an election (PTE tax election) to be taxed at the entity level. PTE tax elections present complex state and federal tax issues for partners and shareholders. Before making an election, care needs to be exercised to avoid state tax traps, especially for nonresident owners, that could exceed any federal tax savings.

#### **OTHER STATE & LOCAL TAXES**

State and local property taxes, sales and use taxes, and other indirect state and local taxes can be the largest piece of an organization's state tax expenditures, even exceeding state and local income and franchise taxes. Just like state income taxes, businesses should understand and plan for their other state and local tax obligations.

Some areas of consideration include:

- Has the business reviewed its sales and use tax nexus footprint, the taxability of its products and services, and whether it is charging the appropriate sales and use tax rates? A comprehensive review of the sales and use tax function along with improving or automating processes may help businesses report and pay the appropriate amount of tax to the correct states and localities.
- Remote retailers, marketplace sellers, and marketplace facilitators (i.e., marketplace providers) should be sure they are in compliance with state sales and use tax laws and marketplace facilitator rules.
- Assessed property tax values typically lag behind market values. Businesses should consider challenging their property tax assessments within the applicable appeal window.
- Businesses should ensure they are properly reporting and remitting unclaimed property to state governments. All 50 states and the District of Columbia require holders to file unclaimed property returns.

## Accounting for Income Taxes – ASC 740 Considerations

The financial year-end close can present unique and challenging issues for tax departments. To avoid surprises, tax professionals can begin now to:

- Evaluate the effectiveness of year-end tax accounting close processes and consider modifications to processes that are not effective. Update work programs and train personnel, making sure all team members understand roles, responsibilities, deliverables, and expected timing. Communication is especially critical in a virtual close.
  - Consider the tax accounting impacts of enacted legislation in 2022. The accounting for tax credits enacted as part of the CHIPS Act and the IRA can be challenging.
  - Stay abreast of pending tax legislation and be prepared to account for the tax effects of legislation that is enacted into law before year end. Whether legislation is considered enacted for purposes of ASC 740 depends on the legislative process in the particular jurisdiction.
  - Document whether and to what extent a valuation allowance should be recorded against deferred tax assets in accordance with ASC 740.
- Depending on the company's situation, this process can be complex and time consuming and may require scheduling deferred tax assets and liabilities, preparing estimates of future taxable income, and evaluating available tax planning strategies.
- Determine and document the tax accounting effects of business combinations, dispositions, and other non-recurring transactions.
  - Review the intra-period tax allocation rules to ensure that income tax expense/ (benefit) is correctly recorded in the financial statements. Depending on a company's transactions, income tax expense/(benefit) could be recorded in continuing operations, discontinued operations, or equity.
  - Evaluate existing and new uncertain tax positions and update supporting documentation.
  - Ensure tax account reconciliations are performed and provide sufficient detail to validate the year-over-year change in tax account balances.
  - Understand required tax footnote disclosures and build the preparation of supporting documentation into the year-end close process.



## Begin Planning for the Future

Businesses should consider actions that will put them on the best path forward for 2022 and beyond. Business can begin now to:

- Establish or build upon a framework for total tax transparency to bring visibility to the company's approach to tax and total tax contribution.
- Reevaluate choice of entity decisions while considering alternative legal entity structures to minimize total tax liability and enterprise risk.
- Evaluate global value chain and cross-border transactions to optimize transfer pricing and minimize global tax liabilities.
- Review available tax credits and incentives for relevancy to leverage within applicable business lines.
- Consider legal entity rationalization, which can reduce administrative costs and provide other benefits and efficiencies.
- Consider the benefits of an ESOP as an exit or liquidity strategy, which can provide tax benefits for both owners and the company.
- Perform a cost segregation study with respect to investments in buildings or renovation of real property to accelerate taxable deductions, claim qualifying bonus depreciation, and identify other discretionary incentives to reduce or defer various taxes.
- Evaluate possible co-sourcing or outsourcing arrangements to assist with priority projects as part of an overall tax function transformation.

