2021 Year-End Tax Planner

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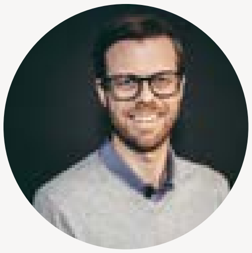


WA Capital Gains Tax

Trent Baeckl, Shareholder

We are entering an age where states are becoming increasingly creative in finding ways to enact new taxes. We saw it last year in Oregon with the new Corporate Activity Tax which was a response to the failed efforts of Measure 97 in 2016 to raise a new corporate tax. Washington followed suit in May 2021 with Senate Bill 5096 which enacted a 7% capital gains "excise" tax effective January 1, 2022. The new tax is applicable for capital gains in excess of $250,000, although there are exemptions for real estate transactions and certain small family businesses. The legality of the new tax is currently in the hands of the courts where there are two ongoing lawsuits arguing the tax is an income tax, therefore violating the Washington constitution. We are unlikely to see a resolution in short order, so we are keeping an eye out for further guidance from the Washington Department of Revenue as we approach the beginning of 2022.

Estate planning

Kim Spaulding, Shareholder

With all the talk of a possible scaled back federal exemption effective in 2022 many clients have been motivated to make use of their historically high federal exemption. Oregon continues to tax estates once they reach $1M and Washington just under $2.2M. Oregon and Washington don't track what is given during life so making lifetime gifts helps avoid state estate tax. Additionally, gifting removes future appreciation from the federal estate and with the right planning can make use of the exemption that is scheduled to be cut in half after 2025. Using trusts to hold these lifetime gifts can be a powerful way to both protect assets and provide flexibility if funds are unexpectedly needed by the donor. A simple way to reduce estate tax is making use of the annual exclusion, which for 2022 is increasing to $16,000 per donee. Tax-free gifts can also be made by paying medical and tuition costs for others directly to medical providers and educational institutions.

International Tax: OECD Two-Pillar Agreement & Potential Changes to U.S. Tax on GILTI

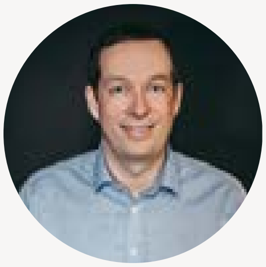
Yulia Sharapova-Leamy, Shareholder

While the international community is closely monitoring the development of the Organization for Economic Cooperation and Development (OECD) two-pillar agreement, which is supposed to address challenges arising from digitalization of the global economy, the US taxpayers with foreign financial holdings are waiting for the final decision on proposed modifications to the US international tax rules. The Global Intangible Low Tax Income (GILTI) regime, which was enacted as part of the 2017 Tax Cuts and Jobs Act, may undergo a significant change resulting in major US tax expenses for US shareholders of Controlled Foreign Corporations. The focus of our international team remains on helping our clients with inbound and outbound investments to stay in compliance and mitigate US taxation under the onerous GILTI regime by utilizing various techniques including an election to tax individual US shareholders of controlled foreign corporations at corporate rates, taking advantage of the entity type elections or modifying entity's structure to avoid the tax burdens of GILTI.

State and Local Update

Sean Wallace, Shareholder

Effective this year Oregon taxpayers, businesses and individuals, residing or deriving income from sources within the Metro and Multnomah County districts will be subject to the two new taxes passed by voters in 2020. Withholdings on wages was optional in 2021 for both the new Metro Supportive Housing Services Income Tax and the Multnomah County Preschool for All Income Tax, but will be mandatory in 2022. For both taxes withholding will be required on employees who work within the jurisdiction boundary and earn $200,000 or more annually. Employees may opt out of withholding if they choose to. Employers located within the Metro boundary should be working with their payroll providers to be ready to withhold starting in January of 2022.



Charitable Contributions

Nick Biller, Director

There is a tax planning opportunity available for donations to charity for 2021. The charitable contribution deduction limitation for individuals is increased from 60% to 100% of Adjusted Gross Income (AGI) for certain donations. In order to qualify, a donation must be a cash contribution to a public charity that is made by the end of 2021. Similar donations made in 2022 will be subject to the 60% of AGI limit. If you are interested in making a large donation, we suggest doing tax planning now to determine the timing that provides a better tax benefit.

We are monitoring the progression of income tax provisions in the Build Back Better Act. One notable provision that may be enacted would increase the itemized deduction limit for state and local taxes (SALT) from $10,000 to $80,000 beginning in 2021. We will provide additional information when we know more.

2021 Year-End Tax Planning for Individuals

As we approach year end, now is the time for individuals, business owners, and family offices to review their 2021 and 2022 tax situations and identify opportunities for reducing, deferring, or accelerating tax obligations.

Areas potentially impacted by proposed tax legislation still in play should be reviewed, as well as applicable opportunities and relief granted under legislation enacted during the past year.

The information contained within this article is based on tax proposals as presented in the November 3, 2021 version of the Build Back Better Act. Our guidance is subject to change when final legislation is passed.

Please consult with your Perkins' advisor when making tax and financial decisions regarding any of the items below.

Individual Tax Planning Highlights

2021 Federal Income Tax Rate Brackets

Tax Rate	Joint/Surviving Spouse	Single	Head of Household	Married Filing Separately	Estate & Trusts
10%	$0 - $19,900	$0 - $9,950	$0 - $14,200	$0 - $9,950	$0 - $2,650
12%	$19,901 - $81,050	$9,951 - $40,525	$14,201 - $54,200	$9,951 - $40,525	-
22%	$81,051 - $172,750	$40,526 - $86,375	$54,201 - $86,350	$40,526 - $86,375	-
24%	$172,751 - $329,850	$86,376 - $164,925	$86,351 - $164,900	$86,376 - $164,925	$2,651 - $9,550
32%	$329,851 - $418,850	$164,926 - $209,425	$164,901 - $209,400	$164,926 - $209,425	-
35%	$418,851 - $628,300	$209,426 - $523,600	$209,401 - $523,600	$209,426 - $314,150	$9,551 - $13,050
37%	Over $628,300	Over $523,600	Over $523,600	Over $314,150	Over $13,050

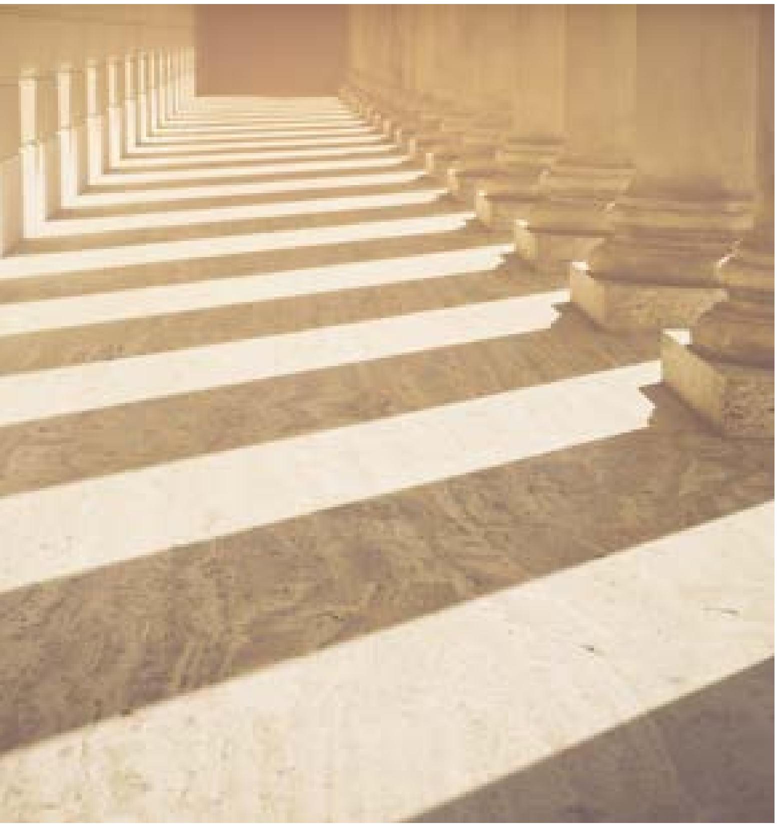
2022 Federal Income Tax Rate Brackets

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 – $2,750
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

Proposed Surcharge on High-Income Individuals, Estates, & Trusts

The draft Build Back Better Act released on November 3, 2021 would impose a 5% surcharge on modified adjusted gross income that exceeds $5 million for married individuals filing separately, $200,000 for estates and trusts and $10 million for all other individuals. An additional 3% surcharge would be imposed on modified adjusted gross income in excess of $12.5 million for married individuals filing separately, $500,000 for estates and trusts and $25 million for all other individuals. The proposal would be effective for taxable years beginning after December 31, 2021 (i.e., beginning in 2022).

While keeping the proposed surcharges in mind, taxpayers should consider whether they can minimize their tax bills by shifting income or deductions between 2021 and 2022. 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 2021 to 2022 will produce a one-year tax deferral and accelerating deductions from 2022 to 2021 will lower the 2021 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 2021 transactions as installment sales so that gain is deferred past 2021 (also see Long Term Capital Gains, below).
- Considering whether to trigger capital losses before the end of 2021 to offset 2021 capital gains.
- Delaying interest or dividend payments from closely held corporations to individual business-owner taxpayers.
- Deferring commission income by closing sales in early 2022 instead of late 2021.
- Accelerating deductions for expenses such as mortgage interest and charitable donations (including donations of appreciated property) into 2021 (subject to AGI limitations).
- Evaluating whether non-business bad debts are worthless by the end of 2021 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 2022 or that would be subject to the proposed 2022 surcharges may want to consider potential ways to move taxable income from 2022 into 2021, such that the taxable income is taxed at a lower tax rate.

Current year actions to consider that could reduce 2022 taxes include:

- Accelerating capital gains into 2021 or deferring capital losses until 2022.
- Electing out of the installment sale method for 2021 installment sales.
- Deferring deductions such as large charitable contributions to 2022.

Long-Term Capital Gains

The long-term capital gains rates for 2021 and 2022 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**.**

2021 Long-Term Capital Gains Rate Brackets

Long-Term Capital Gains Tax Rate	Joint/Surviving Spouse	Single	Head of Household	Married Filing Separately	Estate & Trusts
0%	$0 - $80,800	$0 - $40,400	$0 - $54,100	$0 - $40,400	$0 - $2,700
15%	$80,801 - $501,600	$40,401 - $445,850	$54,101 - $473,750	$40,401 - $250,800	$2,701 - $13,250
20%	Over $501,600	Over $445,850	Over $473,750	Over $250,800	Over $13,250

2022 Long-Term Capital Gains Rate Brackets

Long-Term Capital Gains 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

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. (Note that the November 3 draft of the Build Back Better Act would limit the 100% and 75% exclusion available for the sale of qualified small business stock for dispositions after September 13, 2021.)
- 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. For 2021, 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.

The November 3 version of the Build Back Better Act would broaden the application of the NIIT. Under the proposed legislation, the NIIT would apply to all income earned by high income taxpayers unless such income is otherwise subject to self-employment or payroll tax. For example, high income pass-through entity owners would be subject to the NIIT on their distributive share income and gain that is not subject to self-employment tax.

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 the following tax planning to minimize their NIIT liabilities:

- Deferring net investment income for the year.
- Accelerating into 2021 income from pass-through entities that would be subject to the expanded definition of net investment income under the proposed tax legislation.

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 $142,800 for 2021 and $147,000 for 2022. 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 2021 and 2022 (the limitations are per person, not per return):

Age	Deduction Limitation 2021	Deduction Limitation 2022
40 or under	$450	$450
Over 40 but not over 50	$850	$850
Over 50 but not over 60	$1,690	$1,690
Over 60 but not over 70	$4,520	$4,510
Over 70	$5,640	$5,640

Retirement Plan Contributions

Individuals may want to maximize their annual contributions to qualified retirement plans and Individual Retirement Accounts (IRAs) while keeping in mind the current proposed tax legislation that would limit contributions and conversions and require minimum distributions beginning in 2029 for large retirement funds without regard to the taxpayer's age.

- The maximum amount of elective contributions that an employee can make in 2021 to a 401(k) or 403(b) plan is $19,500 ($26,000 if age 50 or over and the plan allows "catch up" contributions). For 2022, these limits are $20,500 and $27,000, 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 die 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.
- 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 2021 is $58,000. The maximum SEP contribution for 2022 is $61,000. 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).

- 2021 could be the final opportunity to convert non-Roth after-tax savings in qualified plans and IRAs to Roth accounts if legislation passes in its current form. Proposed legislation would prohibit all taxpayers from funding Roth IRAs or designated Roth accounts with after-tax contributions starting in 2022, and high-income taxpayers from converting retirement accounts attributable to pre-tax or deductible contributions to Roths starting in 2032.
- Proposed legislation would require wealthy savers of all ages to substantially draw down retirement balances that exceed $10 million after December 31, 2028, with potential income tax payments on the distributions. As account balances approach the mandatory distribution level, extra consideration should be given before making an annual contribution.

Foreign Earned Income Exclusion

The foreign earned income exclusion is $108,700 in 2021, to be increased to $112,000 in 2022.

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 2021 are $73,600 for unmarried individuals and individuals claiming head of household status, $114,600 for married individuals filing jointly and surviving spouses, $57,300 for married individuals filing separately and $25,700 for estates and trusts. For 2022, those amounts are $75,900 for unmarried individuals and individuals claiming the 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

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 (TCJA) 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.

The November 3 draft of the Build Back Better Act would extend the TCJA SALT deduction limitation through 2031 and increase the deduction limitation amount to $72,500 ($32,250 for estates, trusts and married individuals filing separately). An amendment currently on the table proposes increasing the deduction limitation amount to $80,000 ($40,000 for estates, trusts and married individuals filing separately). The proposal would be effective for taxable years beginning after December 31, 2020, therefore applying to the 2021 calendar year.

Charitable Contributions

The Taxpayer Certainty and Disaster Relief Act of 2020 extended the temporary suspension of the AGI limitation on certain qualifying cash contributions to publicly supported charities under the CARES Act. As a result, individual taxpayers are permitted to take a charitable contribution deduction for qualifying cash contributions made in 2021 to the extent such contributions do not exceed the taxpayer's AGI. Any excess carries forward as a charitable contribution that is usable in the succeeding five years. Contributions to non-operating private foundations or donor-advised funds are not eligible for the 100% AGI limitation.

The limitations for cash contributions continue to be 30% of AGI for non-operating private foundations and 60% of AGI for donor advised funds. The temporary suspension of the AGI limitation on qualifying cash contributions will no longer apply to contributions made in 2022. Contributions made in 2022 will be subject to a 60% AGI limitation.

Tax planning around charitable contributions may include:

- Maximizing 2021 cash charitable contributions to qualified charities to take advantage of the 100% AGI limitation.
- Deferring large charitable contributions to 2022 if the taxpayer would be subject to the proposed individual surcharge tax.
- 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

The November 3 draft of the Build Back Better Act does not include any changes to the estate and gift tax rules. For gifts made in 2021, the gift tax annual exclusion is $15,000 and for 2022 is $16,000. For 2021, the unified estate and gift tax exemption and generation-skipping transfer tax exemption is $11,700,000 per person. For 2022, the exemption is $12,060,000. All outright gifts to a spouse who is a U.S. citizen are free of federal gift tax. However, for 2021 and 2022, only the first $159,000 and $164,000, respectively, of gifts to a non-U.S. citizen spouse are 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

The CARES Act permitted individuals with net operating losses generated in taxable years beginning after December 31, 2017, and before January 1, 2021, to carry those losses back five taxable years. The unused portion of such losses was eligible to be carried forward indefinitely and without limitation. Net operating losses generated beginning in 2021 are subject to the TCJA rules that limit carryforwards to 80% of taxable income and do not permit losses to be carried back.

Excess Business Loss Limitation

A non-corporate taxpayer may deduct net business losses of up to $262,000 ($524,000 for joint filers) in 2021. The limitation is $270,000 ($540,000 for joint filers) for 2022. The November 3 draft of the Build Back Better Act would make permanent the excess business loss provisions originally set to expire December 31, 2025. The proposed legislation would limit excess business losses to $500,000 for joint fliers ($250,000 for all other taxpayers) and treat any excess as a deduction attributable to a taxpayer's trades or businesses when computing excess business loss in the subsequent year.

2021 Year-End Tax Planning for Businesses

As the U.S. entered 2021, many assumed that newly elected President Joe Biden along with Democratic majorities in the House and Senate would swiftly enact tax increases on both corporations and individuals to pay for the cost of proposed new infrastructure and social spending plans, potentially using the budget reconciliation process to do so. Since then, various versions of tax and spending measures have been negotiated and debated by members of Congress and the White House. As 2021 heads to a close, tax increases are still expected, but the timing and content of final changes are still not certain.

On November 19, 2021, the U.S. House of Representatives passed its version of the Build Back Better Act (H.R. 5376), a package of social spending measures funded by tax increases. Some of the legislation's major tax proposals, which mainly target large profitable corporations and high-income individuals, include:

- A 15% corporate alternative minimum tax on companies that report financial statement profits of over $1 billion.
- A 1% surtax on corporate stock buybacks.
- A 15% country-by-country minimum tax on foreign profits of U.S. corporations.
- A 5% surtax on individual incomes over $10 million, an additional 3% surtax on incomes over $25 million and expansion of the 3.8% Net Investment Income Tax.

The legislation will now be taken up by the Senate. If enacted in its current form, the legislation would generally be effective for taxable years beginning after December 31, 2021; however, many of the corporate and international proposals affecting businesses would apply for taxable years beginning after December 31, 2022 – i.e., they would be deferred for one year.

The information contained in this article is based on tax proposals as of November 19, 2021 and is subject to change based on final legislation. Businesses should continue to track the latest tax proposals to understand the impacts of possible new legislation, particularly when engaging in tax planning. Despite the delays and uncertainty around exactly what tax changes final legislation will contain, there are actions that businesses can consider taking to minimize their tax liabilities.

Consider Tax Accounting Method Changes & Strategic Tax Elections

The 2017 Tax Cuts and Jobs Act (TCJA) lowered the regular corporate tax rate to 21% and eliminated the corporate alternative minimum tax beginning in 2018. The current version of the proposed Build Back Better Act would leave the 21% regular corporate tax rate unchanged but, beginning in 2023, would create a new 15% corporate alternative minimum tax on the adjusted financial statement income of corporations with such income over $1 billion. Companies with adjusted financial statement income over $1 billion, therefore, should take into account the proposed 15% corporate alternative minimum tax when considering 2021 tax planning actions that could affect future years.

Companies that want to reduce their 2021 tax liability should consider traditional tax accounting method changes, tax elections and other actions for 2021 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.
- 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 paid within 2.5 months of year end.
- Accelerating deductions of liabilities such as warranty costs, rebates, allowances and product returns under the "recurring item exception."
- Purchasing qualifying property and equipment before the end of 2021 to take advantage of the 100% bonus depreciation provisions and the Section 179 expensing rules.

- Deducting "catch-up" depreciation (including bonus depreciation, if applicable) by changing to shorter recovery periods or changing from non-depreciable to depreciable.
- Optimizing the amount of uniform capitalization costs capitalized to ending inventory, including changing to simplified methods available under Section 263A.
- Electing to fully deduct (rather than capitalize and amortize) qualifying research and experimental (R&E) expenses attributable to new R&E programs or projects that began in 2021. Similar planning may apply to the deductibility of software development costs attributable to new software projects that began in 2021. (Note that capitalization and amortization of R&E expenditures is required beginning in 2022, although the proposed Build Back Better Act would delay the effective date until after 2025).
- Electing to write-off 70% of success-based fees paid or incurred in 2021 in connection with certain acquisitive transactions under Rev. Proc. 2011-29.
- 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 2021 if, for example, they believe tax rates will increase in the near future or they want to optimize usage of NOLs. These businesses may want to consider "reverse" planning strategies, such as:

- Implementing a variety of "reverse" tax accounting method changes.
- Selling and leasing back appreciated property before the end of 2021, 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 2021.
- Electing out of the installment sale method for installment sales closing in 2021.
- Delaying payments of liabilities whose deduction is based on when the amount is paid, so that the payment is deductible in 2022 (e.g., paying year-end bonuses after the 2.5-month rule).

Write-Off Bad Debts & Worthless Stock

Given the economic challenges brought on by the COVID-19 pandemic, businesses should evaluate whether losses may be claimed on their 2021 returns related to worthless assets such as receivables, property, 80% owned subsidiaries or other investments.

- 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 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).
- Certain losses attributable to COVID-19 may be eligible for an election under Section 165(i) to be claimed on the preceding taxable year's return, possibly reducing income and tax in the earlier year or creating an NOL that may be carried back to a year with a higher tax rate.

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 2021 taxable year should be cognizant of the accelerated December 31, 2021 due date for filing Form 3115.

Only certain changes may be implemented without a Form 3115.

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 $26 million ($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).
- The Build Back Better Act proposes to modify the rules with respect to business interest expense paid or incurred by partnerships and S corporations (see Partnerships and S corporations, below).

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.

- Make sure the business has filed carryback claims for all permitted NOL carrybacks. The CARES Act allows taxpayers with losses to carry those losses back up to five years when the tax rates were higher. Taxpayers can still file for "tentative" refunds of NOLs originating in 2020 within 12 months from the end of the taxable year (by December 31, 2021 for calendar year filers) and can file refund claims for 2018 or 2019 NOL carrybacks on timely filed amended returns.
- Corporations should monitor their equity movements to avoid a Section 382 ownership change that could limit annual NOL deductions.
- Losses of pass-throughs entities must meet certain requirements to be deductible at the partner or S corporation owner level (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 (QSBS). The Build Back Better Act would limit the gain exclusion to 50% for sales or exchanges of QSBS occurring after September 13, 2021 for high-income individuals, subject to a binding contract exception. 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 2021 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 for 2021 and begin exploring new tax credit opportunities for 2022.

- The Employee Retention Credit (ERC) is a refundable payroll tax credit for qualifying employers that have been significantly impacted by COVID-19. Employers that received a Paycheck Protection Program (PPP) loan can claim the ERC but the same wages cannot be used for both programs. The Infrastructure Investment and Jobs Act signed by President Biden on November 15, 2021, retroactively ends the ERC on September 30, 2021, for most employers.
- Businesses that incur expenses related to qualified research and development (R&D) activities are eligible for the federal R&D credit.
- Taxpayers that reinvest capital gains in Qualified Opportunity Zones may be able to defer the federal tax due on the capital gains. An additional 10% gain exclusion also may apply if the investment is made by December 31, 2021. The investment must be made within a certain period after the disposition giving rise to the gain.
- 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. In addition, the Build Back Better Act proposes to extend and enhance certain green energy credits as well as introduce a variety of new incentives. The proposals also would introduce the ability for taxpayers to elect cash payments in lieu of certain credits and impose prevailing wage and apprenticeship requirements in the determination of certain credit amounts.

Partnerships & S Corporations

The Build Back Better Act contains various tax proposals that would affect partnerships, S corporations and their owners. Planning opportunities and other considerations for these taxpayers include the following:

- 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 2021.
- 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 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 2021 to maximize their loss deductions. The Build Back Better Act would make the excess business loss limitation permanent (the limitation is currently scheduled to expire for taxable years beginning on or after January 1, 2026) and change the manner in which the carryover of excess business losses may be used in subsequent years.
- 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. Under the Build Back Better Act, the abandonment or worthlessness of a partnership interest would generate a capital loss regardless of partnership liability allocations, effective for taxable years beginning after December 31, 2021. Taxpayers should consider an abandonment of a partnership interest in 2021 to be able to claim an ordinary deduction.
- 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. Although the Build Back Better Act currently does not propose changes to the carried interest rules, an earlier draft of the bill would have extended the current three-year property holding period to five years. Additionally, there are multiple bills in the Senate that, if enacted, would seek to tax all carry allocations at ordinary income rates.
- Under the Build Back Better Act, essentially all pass-through income of high-income owners that is not subject to self-employment tax would be subject to the 3.8% Net Investment Income Tax (NIIT). This means that pass-through income and gains on sales of assets allocable to partnership and S corporation owners would incur NIIT, even if the owner actively participates in the business. Additionally, taxpayers that currently utilize a state law limited partnership to avoid self-employment taxes on the distributive shares of active "limited partners" would instead be subject to the 3.8% NIIT. If enacted, this proposal would be effective for taxable years beginning after December 31, 2021. Taxpayers should consider accelerating income and planned dispositions of business assets into 2021 to avoid the possible additional tax.
- The Build Back Better Act proposes to modify the rules with respect to business interest expense incurred by partnerships and S corporations effective for taxable years beginning after December 31, 2022. Under the proposed bill, the Section 163(j) limitation with respect to business interest expense would be applied at the partner and S corporation shareholder level. Currently, the business interest expense limitation is applied at the entity level (also see Maximize interest expense deductions, above).
- 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.

Planning for International Operations

The Build Back Better Act proposes substantial changes to the existing U.S. international taxation of non-U.S. income beginning as early as 2022. These changes include, but are not limited to, the following:

- Imposing additional interest expense limitations on international financial reporting groups.
- Modifying the rules for global intangible low-taxed income (GILTI), including calculating GILTI and the corresponding foreign tax credits (FTCs) on a country-by-country basis, allowing country specific NOL carryforwards for one taxable year and reducing the QBAI reduction to 5%.
- Modifying the existing FTC rules for all remaining categories to be calculated on a country-by-country basis.
- Modifying the rules for Subpart F, foreign derived intangible income (FDII) and the base erosion anti-abuse tax (BEAT).
- Imposing new limits on the applicability of the Section 245A dividends received deduction (DRD) by removing the application of the DRD rules to non-controlled foreign corporations (CFCs).
- Modifying the rules under Section 250 to remove the taxable income limitation as well as reduce the GILTI and FDII deductions to 28.5% and 24.8%, respectively.

Businesses with international operations should gain an understanding of the impacts of these proposals on their tax profile by modeling the potential changes and considering opportunities to utilize the favorable aspects of the existing cross-border rules to mitigate the detrimental impacts, including:

- Considering mechanisms/methods to accelerate foreign source income (e.g., prepaying royalties) and associated foreign income taxes to maximize use of the existing FTC regime and increase current FDII benefits.
- Optimizing offshore repatriation and associated offshore treasury aspects while minimizing repatriation costs (e.g., previously taxed earnings and profits and basis amounts, withholding taxes, local reserve restrictions, Sections 965 and 245A, etc.).
- Accelerating dividends from non-CFC 10% owned foreign corporations to maximize use of the 100% DRD currently available.
- Utilizing asset step-up planning in low-taxed CFCs to utilize existing current year excess FTCs in the GILTI category for other CFCs in different jurisdictions.
- Considering legal entity restructuring to maximize the use of foreign taxes paid in jurisdictions with less than a 16% current tax rate to maximize the GILTI FTC profile of the company.

- If currently in NOLs, considering methods to defer income or accelerate deductions to minimize detrimental impacts of existing Section 250 deduction taxable income limitations in favor of the proposed changes that will allow a full Section 250 deduction without a taxable income limitation.
- In combination with the OECD Pillar One/Two advancements coupled with U.S. tax legislation, reviewing the transfer pricing and value chain structure of the organization to consider ways to adapt to such changes and minimize the future effective tax rate of the organization.

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 COVID-19) 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 recent 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 2021 and head into 2022:

- Employers have until the extended due date of their 2021 federal income tax return to retroactively establish a qualified retirement plan and fund the plan for 2021.
- Contributions made to a qualified retirement plan by the extended due date of the 2021 federal income tax return may be deductible for 2021; contributions made after this date are deductible for 2022.
- The amount of any PPP loan forgiveness is excluded from the federal gross income of the business, and qualifying expenses for which the loan proceeds were received are deductible.
- 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 half of the deferred amount must be paid by December 31, 2021 (the other half 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 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, 2022) for the bonus to be deductible in 2021. However, the bonus compensation must be paid before the end of 2021 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; and payroll tax, benefits, and transfer pricing issues.

State & Local Taxes

Businesses should monitor the tax rules in the states in which they operate or make sales. Taxpayers that cross state borders—even virtually—should review state nexus and other policies to understand their compliance 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 2021 and 2022:

- Does the state conform to federal tax rules (including recent federal legislation) or decouple from them? Not all states follow federal tax rules. (Note that states do not necessarily follow the federal treatment of PPP loans. See Considerations for employers, above.)
- 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. Has the business considered how these differ from federal and the effect on its state taxable income and deductions?
- Has the business amended any federal returns? 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 there is no change to state taxable income or deductions.
- Has a state adopted economic nexus for income tax purposes, enacted NOL deduction suspensions or limitations, increased rates or suspended or eliminated some tax credit and incentive programs to deal with lack of revenues due to COVID-19 economic issues?
- The majority of states now impose single-sales factor apportionment formulas and require market-based sourcing for sales of services and licenses/sales of intangibles using disparate sourcing methodologies. Has the business recently examined whether its multistate apportionment of income is consistent with or the effect of this trend?
- Consider the state and local tax treatment of merger, acquisition and disposition transactions, and do not forget that internal reorganizations of existing structures also have state tax impacts. There are many state-specific considerations when analyzing the tax effects of transactions.
- Is the business claiming all available state and local tax credits, e.g., for research activities, employment or investment?
- For businesses selling remotely and that have been protected by P.L. 86-272 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?
- Has the business considered the state tax impacts of its mobile workforce? 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).

- Has the state introduced (or is it considering introducing) a tax on digital services? The definition of digital services can potentially be very broad and fact specific. Taxpayers should understand the various state proposals and plan for potential impacts.
- 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. Consider challenging your property tax assessment.

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). At least 20 states have enacted potential 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 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. (Note that the Build Back Better Act proposes to increase the state and local tax deduction limitation for individuals to $80,000 ($40,000 for married individuals filing separately) retroactive to taxable years beginning after December 31, 2020. In addition, the Senate has begun working on a proposal that would completely lift the deduction cap subject to income limitations.)

Accounting for Income Taxes – ASC 740 Considerations

The financial year-end close can present unique and challenging issues for tax departments. Further complicating matters is pending U.S. tax legislation that, if enacted by the end of the calendar year, will need to be accounted for in 2021.

To avoid surprises, tax professionals can begin now to prepare for the year-end close:

- Evaluate the effectiveness of year-end tax accounting close processes and consider modifications to processes that are not ideal. 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.
- Know where there is pending tax legislation and be prepared to account for the tax effects of legislation that is "enacted" 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 unique 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 activities, income tax expense/(benefit) could be recorded in continuing operations as well as other areas of the financial statements.
- Evaluate existing and new uncertain tax positions and update supporting documentation.
- Make sure tax account reconciliations are current and provide sufficient detail to prove the year-over-year change in tax account balances.
- Understand required tax footnote disclosures and build the preparation of relevant documentation and schedules into the year-end close process.

Begin Planning for the Future

Future tax planning will depend on final passage of the proposed Build Back Better Act and precisely what tax changes the final legislation contains. Regardless of legislation, businesses should consider actions that will put them on the best path forward for 2022 and beyond. Businesses can begin now to:

- 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 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, and identify other discretionary incentives to reduce or defer various taxes.
- Perform a state-by-state analysis to ensure the business is properly charging sales taxes on taxable items, but not exempt or non-taxable items, and to determine whether the business needs to self-remit use taxes on any taxable purchases (including digital products or services).
- Evaluate possible co-sourcing or outsourcing arrangements to assist with priority projects as part of an overall tax function transformation.