2022 YEAR-END INCOME TAX PLANNING FOR BUSINESSES

INTRODUCTION

It's hard to believe we are already nearing the end of 2022. As we begin looking forward to the possibilities of a new year, it's important to take a moment to look back and review 2022 for possible tax planning opportunities for your business. We believe examining your 2022 tax situation could lead to tax savings when you file. To assist you in your planning, we have included our 2022 year-end income tax planning letter for businesses. We've included selected traditional as well as selected new planning ideas for you to consider. If you have any questions or want to discuss planning ideas not included in our letter, please call our firm.

Caution! The IRS continues releasing guidance on various important tax provisions. We closely monitor new tax legislation and IRS releases. Please call our firm if you want an update on the latest tax legislation, IRS notifications, announcements, and guidance or **if you need additional information concerning any item discussed in this letter.**

Be careful! Although this letter contains planning ideas, you cannot properly evaluate a particular planning strategy without calculating the overall tax liability for the business and its owners (including the alternative minimum tax) with and without the strategy. In addition, this letter contains ideas for Federal income tax planning only. **State income tax issues are not addressed.** However, you should consider the state income tax impact of a particular planning strategy. We recommend that **you call our firm before implementing any tax planning technique** discussed in this letter.

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POSSIBLE LEGISLATION BEFORE YEAR-END

Each year we work to provide you with our year-end planning letter in time to allow implementation of possible tax saving strategies that may need to be completed before December 31st. As a result, it is possible Congress could pass new legislation between your receipt of this letter and December 31st. There are over 30 temporary tax provisions that expired at the end of 2021, many of which were energy related and were extended or changed by the Inflation Reduction Act of 2022. However, it appears a December omnibus spending package is the best chance for an extension of several expired or expiring provisions. Please contact our firm if you'd like an update on current legislation and how it could affect your business.

TRADITIONAL YEAR-END TAX PLANNING TECHNIQUES

Pay Special Attention To Timing Issues. For most businesses, the last several years have been difficult. The pandemic, disruptions in the supply chain, and difficulty hiring and retaining employees has caused many businesses to face unprecedented challenges. One of the traditional year-end tax planning strategies for businesses includes reducing current year taxable income by deferring taxable income into later years and accelerating deductions into the current one. This strategy has been particularly beneficial where the income tax rate on the business's income in the following year is expected to be the same or lower than the current year. For businesses that have done well during the pandemic, this strategy would still generally be advisable. **Caution!** In the following discussions we include "timing" suggestions as they relate to traditional year-end tax planning strategies that would cause you to accelerate deductions into 2022, while deferring income into 2023. However, for businesses that expect their taxable income to be significantly lower in 2022 than in 2023, the opposite strategy might be more advisable. In other words, for struggling businesses, a better year-end planning strategy could include accelerating revenues into 2022 (to be taxed at lower rates), while deferring deductions to 2023 (to be taken against income that is expected to be taxed at higher rates). **Planning Alert!** The 20% 199A deduction that was first available in 2018 adds another wrinkle to deciding whether to defer or accelerate revenues, and/or to defer or accelerate deductions. As discussed in more detail below, your ability to take maximum advantage of the 20% 199A deduction for 2022 and/or 2023 may, in certain situations, be enhanced significantly if you are able to keep your taxable income below certain thresholds. Consequently, please keep that factor in mind as you read through the following timing strategies for income and deductions.

Planning With The First-Year 168(k) Bonus Depreciation Deduction. Traditionally, a popular way for businesses to maximize current-year deductions has been to take advantage of the **First-Year 168(k) Bonus Depreciation deduction.** Before the *"Tax Cuts and Jobs Act"* (TCJA) which was enacted in late 2017, the 168(k) Bonus Depreciation deduction was equal to 50% of the cost of qualifying **new** depreciable assets placed in service. TCJA temporarily increased the 168(k) Bonus Depreciation deduction **to 100%** for qualifying property acquired and placed in service **after September 27, 2017** and **before January 1, 2023.**

Planning Alert! After 2022 the 100% §168(k) deduction is to be reduced as follows for property placed in service: **1)** During **2023 - 80%, 2)** During **2024 - 60%, 3)** During **2025 - 40%, 4)** During **2026 - 20%,** and **5) After 2026 - 0%** (with an additional year for long-production-period property and noncommercial aircraft).

TCJA further enhanced the 168(k) Bonus Depreciation deduction by making the following changes:

- **"Used" Property Temporarily Qualifies For 168(k) Bonus Depreciation.** Before TCJA, only **"new"** qualifying property was eligible for the 168(k) Bonus Depreciation deduction. For qualifying property acquired and placed in service **after September 27, 2017 and before 2027,** the 168(k) Bonus Depreciation may be taken on **"new" or "used"** property. Therefore, property that generally qualifies for the 168(k) Bonus Depreciation includes **"new"** or **"used"** business property that has a depreciable life for tax purposes of **20 years or less** (e.g., machinery and equipment, furniture and fixtures, sidewalks, roads, landscaping, computers, computer software, farm buildings, and qualified motor fuels facilities).

- **<u>Note! The 100% 168(k) Bonus Depreciation Deduction For "Used" Property Generally Makes Cost Segregation Studies More Valuable.</u>** Depreciable components of a building that are properly classified as depreciable personal property under a **cost segregation study** are generally depreciated over 5 to 7 years. **Before TCJA,** these depreciable building components for a purchaser of a "used" building generally qualified for the 179 Deduction (subject to the dollar caps), but did not qualify for a 168(k) Bonus Depreciation deduction because the 168(k)-depreciation deduction only applied to "new" property. However, after TCJA, the depreciable components of a building that are properly classified as "personal property" (as opposed to "real property") will qualify for the 100% 168(k) Bonus Depreciation (whether new or used).

- **<u>Annual Depreciation Caps For Passenger Vehicles Increased.</u>** Vehicles used primarily in business generally qualify for the 168(k) Bonus Depreciation. However, there is a dollar cap imposed on business cars, and on trucks, vans, and SUVs that have a **loaded vehicle weight of 6,000 lbs. or less.** This dollar cap was increased significantly under TCJA. More specifically, for qualifying vehicles placed in service **in 2022** and used 100% for business, the annual depreciation caps are as follows: **1st year - $11,200; 2nd year - $18,000; 3rd year - $10,800; fourth and subsequent years - $6,460.** Moreover, if the vehicle (new or used) otherwise qualifies for the 168(k) Bonus Depreciation, the first-year depreciation cap (assuming 100% business use) is increased by $8,000 (i.e., **from $11,200 to $19,200 for 2022).** Thus, a vehicle otherwise qualifying for the 168(k) Bonus Depreciation deduction with loaded **Gross Vehicle Weight (GVW) of 6,000 lbs. or less** used **exclusively for business** and **placed in service in 2022** would be entitled to a **depreciation deduction for 2022 of up to $19,200,** whether purchased new or used. If the vehicle continues to be used exclusively for business during the **second year** (i.e., during 2023), it would be entitled to a second-year depreciation deduction of **up to $18,000. <u>Planning Alert!</u>** Even better, if the same new or used business vehicle (which is used 100% for business) has a loaded GVW **over 6,000 lbs., 100% of its cost** (without a dollar cap) could be deducted **in 2022** as a **168(k) Bonus Depreciation deduction.**

- **<u>168(k) Bonus Depreciation Taken In Tax Year Qualifying Property Is "Placed In Service."</u>** The 168(k) Bonus Depreciation deduction is taken in the tax year the qualifying property is "placed in service." Consequently, if your business anticipates acquiring qualifying 168(k) property between now and the end of the year, the 168(k) Bonus Depreciation deduction is taken in 2022 if the property is placed in service no later than December 31, 2022, if the business has a calendar tax year. Alternatively, the 168(k) Bonus Depreciation deduction can be deferred until 2023 if the qualifying property is placed in service in 2023. However, the 168(k) depreciation deduction is limited to 80% of the basis of the property if placed in service in 2023. Generally, if you are purchasing "personal property" (equipment, computer, vehicles, etc.), "placed in service" means the property is **ready and available** for use (this commonly means the date on which the property has been **set up and tested).** If you are dealing with building improvements (e.g., "Qualified Improvement Property"), the date on the **Certificate of Occupancy** is commonly considered the date the qualifying building improvements are placed in service. **<u>Note!</u>** Unlike the 179 Deduction (discussed next), the 168(k) Bonus Depreciation deduction is automatically allowed unless the business timely **elects out** of the deduction. However, the 179 deduction is not allowed unless the business makes an **affirmative election to take it.**

<u>Planning With The Section 179 Deduction.</u> Another popular and frequently used way to accelerate deductions is by taking maximum advantage of the up-front Section 179 Deduction ("179 Deduction"). TCJA made several taxpayer-friendly enhancements to the 179 Deduction which include: **1)** Substantially increasing the 179 Deduction limitation (up to **$1,080,000 for 2022**), **2)** Increasing the phase-out threshold for total purchases of 179 property (**$2,700,000 for 2022**), and **3)** Expanding the types of business property that qualify for the 179 Deduction. **<u>Planning Alert!</u>** To maximize your 179 Deductions for 2022, it is important for your business to determine which depreciable property acquired during the year qualifies as 179 Property. The following is a list of the types of business property that qualify for the 179 Deduction (as expanded by TCJA):

- **<u>General Definition Of 179 Property.</u>** Generally, "depreciable" property qualifies for the **179 Deduction** if: **1)** It is purchased **new or used, 2)** It is "tangible personal" property, **and 3)** It is used primarily for business purposes (e.g., machinery and equipment, furniture and fixtures, business computers, etc.). Off-the-shelf business software also qualifies. **Planning Alert! Before TCJA,** the 179 Deduction was not allowed for property used in **connection with lodging** (other than hotels, motels, etc.). TCJA removed this restriction, so the 179 Deduction **is now allowed** for otherwise qualifying property used in connection with lodging (e.g., the cost of furnishing a home that the owner is renting to others would now qualify).

- **Expanded Definition Of "Qualified Real Property." Before TCJA,** property that qualified for the 179 Deduction also included **"Qualified Real Property"** (i.e., certain leasehold improvements to existing commercial buildings; certain costs of acquiring and/or improving restaurant buildings; and certain costs of improving the interior of existing buildings used for retail sales). **For property placed in service in tax years beginning after 2017,** TCJA changed the definition of **"Qualified Real Property"** (which qualifies for the 179 Deduction) to mean any of the following **"improvements" to an existing commercial** (i.e., nonresidential) building that are **placed in service after** the **commercial building was first placed in service: 1) "Qualified Improvement Property", 2) Roofs, 3) Heating, Ventilation, and Air-Conditioning Property, 4) Fire Protection and Alarm Systems,** and **5) Security Systems. Tax Tip!** Determining whether a major repair to a building's roof should be capitalized or deducted immediately as a repair under capitalization regulations, is not always an easy task. Since new roofs with respect to an existing commercial building may now qualify for the 179 Deduction, in many situations, the "capitalization vs. repair" issue relating to the replacement of roofs should largely be eliminated where the 179 limitation caps for the year are not exceeded. **Planning Alert!** "Qualified Improvement Property" (QIP) also qualifies for the 100% 168(k) first-year bonus depreciation deduction as well as for the 179 Deduction, subject to the dollar limitation listed previously. "Qualified Improvement Property" generally means improvements to the interior portion of a commercial building which are placed in service after the building is placed in service and which do not expand the floor space of the building and do not involve the internal structural framework of the building.

- **Business Vehicles.** New or used business vehicles generally qualify for the 179 Deduction, provided the vehicle is **used more-than-50% in your business. Planning Alert!** As discussed previously in the 168(k) Bonus Depreciation segment, there is a dollar cap imposed on business cars and trucks that have a **loaded vehicle weight of 6,000 lbs. or less.** If applicable, this dollar cap applies to both the 168(k) Bonus Depreciation and the 179 Deduction taken with respect to the vehicle.

  - **"Heavy Vehicles" Exempt From Dollar Caps.** Trucks, vans, and SUVs that **weigh over 6,000 lbs.** are exempt from the annual depreciation caps. In addition, these vehicles if used more-than-50% in business, will also generally qualify for a **179 Deduction of up to $27,000** if placed in service in 2022 (if placed in service in 2023 the limit will be **$28,900). Tax Tip!** Pickup trucks with loaded vehicle weights over 6,000 lbs. are exempt from the $27,000 limit to the 179 Deduction if the truck bed is at least six feet long. **Planning Alert!** The $27,000 cap applies only for purposes of the 179 Deduction. This $27,000 cap **does not apply** with respect to the 168(k) Bonus Depreciation deduction taken on vehicles weighing over 6,000 lbs.

  - **Tax Tip!** Neither the **179 Deduction** nor the 168(k) Bonus Depreciation deduction requires any proration based on the length of time that an asset is in service during the tax year. Therefore, your calendar-year business would get the benefit of the **entire 179 or 168(k) Deduction** for 2022 purchases, even if the qualifying property **was placed in service as late as December 31, 2022!** However, you would claim the 168(k) and 179 deductions in 2023 if the qualifying property was placed in service on January 1, 2023, or after. Therefore, if you want the deduction for 2022, make sure the vehicle or other qualifying property is placed in service in 2022.

- **The 100% 168(k) Depreciation Deduction Has Temporarily Made The Section 179 Taxable Income Limitation Less Important.** The 179 Deduction is limited to a taxpayer's "trade or business" taxable income (determined without the 179 Deduction) for the tax year. Any excess 179 Deduction over the "taxable income limitation" is carried forward to later years until the taxpayer generates enough business taxable income to fully deduct it. This generally means that this "taxable income limitation" will not limit the taxpayer's Section 179 Deduction for a specific tax year so long as the taxpayer has aggregate net income (before the section 179 Deduction) from all trades or businesses at least equal to the 179 Deduction for that tax year. For this purpose, an individual's trade or business income includes W-2 wages reported by the individual and/or the individual's spouse (if filing a joint return).

<u>**Planning Alert!**</u> There is **no "taxable income limitation" or $27,000 cap** with respect to the 168(k) Bonus Depreciation deduction. Therefore, for example, a taxpayer could deduct the full cost of an SUV weighing over 6,000 lbs. purchased in 2022 and used entirely in business as a **168(k) Bonus Depreciation deduction** without being limited by the $27,000 cap, and regardless of the amount of the taxpayer's taxable income.

<u>**Salaries For S Corporation Shareholder/Employees.**</u> For 2022, an employer generally must pay FICA taxes of 7.65% on an employee's wages up to $147,000 ($160,200 for 2023) and FICA taxes of 1.45% on wages in excess of $147,000 ($160,200 for 2023). In addition, an employer must withhold FICA taxes from an employee's wages of 7.65% on wages up to $147,000 ($160,200 for 2023), and 1.45% of wages in excess of $147,000 ($160,200 for 2023). Generally, the employer must also withhold an additional Medicare tax of .9% for wages paid to an employee in excess of $200,000. If you are a shareholder/employee of an S corporation, this FICA tax generally applies only to your W-2 income from your S corporation. Other income that passes through to you or is distributed with respect to your stock is generally not subject to FICA taxes or to self-employment taxes.

- <u>**Compensation Must Be "Reasonable."**</u> If the IRS determines that you have taken unreasonably "low" compensation from your S corporation, it will generally argue that other amounts you have received from your S corporation (e.g., distributions) are disguised "compensation" and should be subject to FICA taxes. Determining "reasonable compensation" for S corporation shareholder/employees continues to be a hot audit issue, and the IRS has a winning record in the Courts. Over the years, the IRS has been particularly successful in reclassifying distributions as wages where S corporation owners pay themselves **no wages** even though they provided significant services to the corporation. However, more recently, there have been several cases where the S corporation owners paid themselves **more than de minimis wages,** but the Court still held that an additional portion of their cash "distributions" should be reclassified as "wages" (subject to payroll taxes).

  <u>**Caution!**</u> Determining "reasonable" compensation for an S corporation shareholder is a case-by-case determination, and there are no rules of thumb for determining whether the compensation is "reasonable." However, Court decisions make it clear that the compensation of S corporation shareholders should be supported by independent data (e.g., comparable industry compensation studies), and should be properly documented and approved by the corporation. <u>**Planning Alert!**</u> Keeping wages low and minimizing your FICA tax could also reduce your Social Security benefits when you retire. Furthermore, if your S corporation has a qualified retirement plan, reducing your wages may reduce the amount of contributions that can be made to the plan on your behalf since contributions to the plan are based on your "wages."

<u>**S Corporation Shareholders Should Check Stock And Debt Basis Before Year-End.**</u> If you own S corporation stock and you think your S corporation will have a tax loss this year, you should contact us as soon as possible. These losses will not be deductible on your personal return unless and until you have adequate "basis" in your S corporation. Any pass-through loss that exceeds your "basis" in the S corporation will carry over to succeeding years. You have basis to the extent of the amounts paid for your stock (adjusted for net pass-through income, losses, and distributions); **plus,** any amounts you have personally loaned to your S corporation. <u>**Planning Alert!**</u> If an S corporation anticipates financing losses through borrowing from an outside lender, the best way to ensure the shareholder gets **debt basis** is to: **1)** Have the shareholder personally borrow the funds from the outside lender, and **2)** Then have the shareholder formally (with proper and timely documentation) loan the borrowed funds to the S corporation. It also may be possible to restructure (with timely and proper documentation) an existing outside loan directly to an S corporation in a way that will give the shareholder debt basis. However, the loan must be restructured before the S corporation's year ends. <u>**Caution!**</u> A shareholder cannot get debt basis by merely guaranteeing a third-party loan to the S corporation. **Please do not attempt to restructure your loans without contacting us first.**

- **<u>Note! IRS Issues Guidance Providing When PPP Loan Forgiveness Recognized For Determining Basis.</u>** Prior to the enactment of the Consolidated Appropriations Act (CAA), the IRS ruled that expenses resulting in PPP loan forgiveness were not deductible. However, CAA retroactively provided that the expenses resulting in PPP loan forgiveness were deductible. However, that good news created a potential problem for some partners and S corporation shareholders. Now that the expenses were deductible and PPP loan proceeds were not included in income, this created a 2020 net operating loss for some partners or S corporation shareholders which could be carried back for 5 years. However, in some cases the partners and shareholders with these passthrough losses did not have sufficient basis to take the loss for 2020 unless the tax-exempt PPP loan proceeds were included in the basis calculation for the 2020 tax year. **<u>Note!</u>** A partner's or S corporation shareholder's allocable share of tax-exempt income increases the basis of the partner in the partnership and the S corporation shareholder's basis in the S corporation. Therefore, the question became "when is the tax-exempt PPP loan amount recognized for purposes of calculating a partner's or shareholder's basis in the partnership or S corporation?" **On November 18, 2021, the IRS issued guidance providing that taxpayers may treat tax-exempt PPP loan forgiveness as received or accrued in one of the following ways: 1) As eligible expenses are paid or incurred, 2) When an application for PPP Loan Forgiveness is filed, or 3) When PPP Loan Forgiveness is granted.**

<u>MAXIMIZE YOUR 20% 199A DEDUCTION FOR QUALIFIED BUSINESS INCOME (QBI)</u>

First effective in 2018, the 20% 199A Deduction has had a major impact on businesses. This provision allows qualified taxpayers to take a 20% Deduction with respect to **"Qualified Business Income," "Qualified REIT Dividends,"** and **"Publicly Traded Partnership Income."** Of these three types of qualifying income, **"Qualified Business Income" (QBI)** has had the biggest impact by far on the greatest number of taxpayers. Consequently, this discussion of the 20% 199A Deduction focuses **primarily on "Qualified Business Income" (QBI). <u>Planning Alert!</u>** The rules for determining the 20% 199A Deduction for Qualified REIT Dividends and Publicly Traded Partnership Income are relatively straight forward.

- **<u>Highlights Of The 20% 199A Deduction For "Qualified Business Income" (QBI).</u>** In certain situations, the rules for determining whether a taxpayer qualifies for the 20% 199A Deduction with respect to **Qualified Business Income (QBI)** can be quite complicated. Consequently, the discussion below provides only an "overview" of the primary requirements a taxpayer must satisfy to be eligible to take the 20% 199A Deduction as it applies to QBI.

- **<u>Who Qualifies For The 20% 199A Deduction With Respect To "Qualified Business Income" (QBI)?</u>** Taxpayers who may qualify for this 20% 199A Deduction are generally taxpayers that report **"Qualified Business Income" (QBI)** as: Individual owners of S corporations or partnerships; Sole Proprietors; Trusts and Estates; and Certain beneficiaries of trusts and estates. **<u>Planning Alert!</u>** The 20% 199A Deduction is available **for tax years beginning after 2017 through 2025,** and is generally taken on the owner's individual income tax return. The 20% 199A Deduction does not reduce the individual owner's "Adjusted Gross Income" (AGI) or impact the calculation of the owner's Self-Employment Tax. Instead, the deduction simply reduces the owner's Taxable Income (regardless of whether the owner itemizes deductions or claims the standard deduction). In other words, the 20%199A Deduction is allowed **in addition to** an individual's itemized deductions or standard deduction.

- **<u>Rules For 20% 199A Deduction For QBI Are Much Simpler For Taxpayers With 2022 "Taxable Income" Of $170,050 Or Below ($340,100 Or Below If Filing Joint Return).</u>** Computing the 20% 199A Deduction for QBI for some taxpayers can be extremely tricky. However, as you read the following discussion, you will discover that certain rules that could otherwise limit the amount of the 20% 199A Deduction do not apply to taxpayers with Taxable Income below certain levels. Consequently, the technical rules for determining (and qualifying for) the 20% 199A Deduction for QBI are far simpler and easier for individuals with 2022 "Taxable Income" (excluding the 20% 199A Deduction) of **$170,050 or below** (**$340,100** or below if married filing jointly).

- **<u>"Qualified Business Income."</u> "Qualified Business Income" (QBI)** that is generally eligible for the 20% 199A Deduction, is defined as the net amount of qualified items of income, gain, deduction, and loss with respect to **"any"** trade or business **<u>other than:</u> 1)** Certain **personal service** businesses known as **"Specified Service Trades Or Businesses"** (described in more detail below), and **2)** The **Trade or Business** of performing services **"as an employee"** (e.g. W-2 wages). **<u>Caution!</u>** QBI also generally **<u>does not include</u>** certain items of income, such as: **1)** Dividends, investment interest income, short-term capital gains, long-term capital gains, income from annuities, commodities gains, foreign currency gains, etc.; **2)** Any **"guaranteed payment"** paid to a partner by the partnership; **3)** Reasonable compensation paid by an S corporation to a shareholder; or **4)** Income you report as an independent contractor (e.g., sole proprietor) where it is ultimately determined that you should have been classified as a "common law" employee.

- **<u>"Depreciation Recapture Income" May Be Treated As QBI.</u>** As noted above, a capital gain or loss (long-term or short-term) is excluded from the determination of QBI. However, on the sale of depreciable "personal" business property, the gain is generally treated as "ordinary" gain (not "capital" gain) to the extent the seller previously took either depreciation or the 179 Deduction with respect to that property. This is commonly referred to as *"Depreciation Recapture Gain." Depreciation Recapture Gain* (i.e., treated as "ordinary" gain) with respect to a qualifying business is included in the calculation of QBI. **<u>Planning Alert!</u>** *Depreciation Recapture Gain* most commonly occurs when a taxpayer sells depreciable ***"personal"*** property (e.g., business equipment, furniture and fixtures, certain business vehicles, etc.). However, as discussed previously, the sale of depreciable ***"real"*** property (e.g., depreciable buildings used in a commercial business) in certain situations can also generate *"Depreciation Recapture Gain."* For example, if a taxpayer takes the 179 Deduction with respect to *qualifying improvements* (e.g., new roof, Qualified Improvement Property) to a commercial building and later sells the building, the sale can trigger *Depreciation Recapture Gain* to the extent of the previous 179 Deduction. If, at the time of the sale, the building had been used in a business that was otherwise generating QBI, the *Depreciation Recapture Gain* on the sale of the building resulting from the 179 Deduction would likewise be included in QBI.

- **<u>"Ordinary Gain" On The Sale Of A Partnership Interest Could Generate QBI.</u>** Generally, the gain on the sale of a partnership interest is classified as a "capital" gain which is excluded from the computation of QBI. However, code section 751 of the internal revenue code requires a partner to treat income from the sale of the partner's partnership interest as "ordinary" gain (not "capital" gain) to the extent of the partner's share of the partnership's *"Unrealized Receivables"* (e.g., zero-basis receivables held by a cash-basis partnership; *Depreciation Recapture Gain* reflected in the partnership's depreciable property) and *"Substantially Appreciated Inventory."* Gain on the sale of a partnership interest to the extent it is treated as "*ordinary*" gain under code section 751(a) is considered attributable to the trades or businesses conducted by the partnership. Therefore, if the partnership is generating QBI at the date of the sale of the partnership interest, the *"ordinary"* gain triggered to the selling partner under code section 751 should also be included in the partner's QBI. **<u>Note!</u>** Unlike partnerships, no portion of the gain or loss on the sale of S corporation stock will be included in the determination of QBI.

- **<u>W-2 Wage And Capital Limitation On The 20% QBI Deduction.</u>** Generally, your 20% QBI Deduction with respect to each Qualified Trade or Business may not exceed **<u>the greater of:</u> 1)** 50% of the allocable share of the business's W-2 wages allocated to the QBI of each "Qualified Trade or Business," or **2)** The sum of 25% of the business's allocable share of W-2 wages with respect to each "Qualified Trade or Business," plus 2.5% of the business's allocable share of unadjusted basis of tangible depreciable property held by the business at the close of the taxable year. **<u>Note!</u>** This limitation, to the extent it applies, is generally designed to ensure that the full 20% of QBI Deduction is available only to qualified businesses that have sufficient W-2 wages, sufficient tangible depreciable business property, or both.

- **<u>Owners With Taxable Income Below Certain Thresholds Are Exempt From The W-2 Wage And Capital Limitation!</u>** For 2022, an otherwise qualifying taxpayer is **entirely exempt** from the **W-2 Wage and Capital Limitation** if the Taxpayer's **"Taxable Income"** (computed without regard to the 20% 199A Deduction) is **$170,050 or below ($340,100** or below if married filing jointly). **<u>Caution!</u>** For 2022, the

Wage and Capital Limitation phases in ratably as a taxpayer's Taxable Income **goes from more than $170,050 to $220,050, or from more than $340,100 to $440,100** (if filing jointly).

- **<u>Business Income From "Specified Service Trade Or Businesses" (SSTBs) Does Not Qualify For The 20% 199A Deduction For Owners Who Have "Taxable Income" Above Certain Thresholds.</u>** Based on your "Taxable Income" (before the 20% 199A Deduction), all or a portion of your qualified business income from a so-called "Specified Service Trade or Business" (i.e., certain service-type operations discussed in more detail below) **may not qualify** for the 20% 199A Deduction. More specifically, if your **"Taxable Income"** for 2022 (before the 20% 199A Deduction) is **$170,050 or below ($340,100 or below** if married **filing jointly), "<u>all</u>"** of the qualified business income from your "Specified Service Trade or Business" **(SSTB)** is eligible for the 20% 199A deduction. However, if for 2022 your **"Taxable Income"** is **$220,050 or more ($440,100 or more** if married **filing jointly)**, **none** of your SSTB income qualifies for the 20% 199A Deduction. **<u>Caution!</u>** If for 2022, your **"Taxable Income"** is **between $170,050 and $220,050** (between **$340,100 and $440,100** if married **filing jointly),** only **"a portion"** of your SSTB income will be eligible for the 20% 199A Deduction.

  <u>Planning Alert!</u> A taxpayer with Taxable Income for 2022 of **$170,050 or less ($340,100 or less** if married **filing jointly)** qualifies for two major benefits: **1)** The taxpayer's SSTB income (if any) is fully eligible for the 20% 199A deduction, ***and*** **2)** The taxpayer is completely exempt from the W-2 Wage and Capital Limitation. Consequently, if you are in a situation where your 20% 199A Deduction would otherwise be significantly reduced (or even eliminated altogether) due to either or both of these limitations, it is even more important that you review year-end strategies that could help you reduce your 2022 taxable income (before the 20% 199A Deduction) to or below the $170,050/$340,100 thresholds.

- **<u>What Is A "Specified Service Trade Or Business" (SSTB)?</u>** A ***Specified Service Trade or Business*** **("SSTB")** is generally defined as **1)** a trade or business activity involved in the performance of services in the field of: health; law; accounting; actuarial science; performing arts; consulting; athletics; financial services; or brokerage services; **2)** a trade or business involving the receipt of fees for celebrity-type endorsements, appearance fees, and fees for using a person's image, likeness, name, etc.; and **3)** any trade or business involving the services of investing and investment management, trading, or dealing in securities, partnership interests, or commodities. An "SSTB" **does not include** the performance of **architectural** or **engineering** services.

  <u>Planning Alert!</u> One of the listed activities that constitutes an SSTB is *"any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees."* The IRS says that this type of SSTB is not nearly as broad as it sounds. More specifically, regulations under section 199A clarify that this classification ***only includes*** the following types of business income: Fees for celebrity-type endorsements, appearance fees, and fees for using a person's image, likeness, name, etc. The regulations also clarify this type of activity **<u>does not include</u>** the income of a business, other than the three types of income listed above, even if the income is generated to a large degree by the good business reputation of the owners and/or employees.

- **<u>Evaluating Reasonable W-2 Compensation Levels Paid To S Corp Owner/Employees Is More Important Than Ever!</u>** Even before the 20% 199A Deduction provision was enacted, S corporation shareholder/employees have had an incentive to pay themselves W-2 wages as low as possible because only the shareholder's W-2 income from the S corporation is subject to FICA taxes. Other income of the shareholder from the S corporation is generally not subject to FICA or Self-Employment (S/E) taxes. Traditionally, where the IRS has determined that an S corporation shareholder/employee has taken unreasonably **"low"** compensation from the S corporation, the IRS has argued that other amounts the shareholder has received from the S corporation (e.g., distributions) are disguised **"compensation"** and should be subject to FICA taxes. In light of the 20% 199A Deduction, reviewing the W-2 wage level for Shareholder/Employees of S Corporations becomes even more important as we illustrate below:

- **For example,** for S Corporation shareholder/employees who expect to have 2022 Taxable Income (before the 20% 199A Deduction) of **$170,050 or less ($340,100 or less** if married filing jointly), **there is a tax incentive** to keep the shareholders' **W-2 wages as "low" as possible,** because: **1)** The W-2 Wages paid to shareholders **do not qualify** for the 20%199A Deduction, but the W-2 Wages **do reduce** a shareholder's pass-through Qualified Business Income, **2)** The shareholder will be exempt from the W-2 Wage and Capital Limitation (so lower W-2 wages will not limit the shareholder's potential 20% 199A Deduction amount), and **3)** The shareholder's pass-through SSTB income (if any) will be eligible for the 20% 199A Deduction, while W-2 wages paid to the shareholder/employee will not qualify. **<u>Caution!</u>** As mentioned previously, the IRS has a long history of attacking S Corporations that it believes are paying shareholder/employees unreasonably low W-2 wages.

  By contrast, for S Corporation shareholder/employees who expect to have Taxable Income (before the 20% 199A Deduction) of **$220,050 or more ($440,100 or more** if married filing jointly), there **may be** a **tax incentive** to **"increase"** the shareholder's W-2 wages if: **1)** The S corporation is generating pass-through Qualified Business Income (QBI), and **2)** The W-2 Wage and Capital Limitation will significantly limit the amount of the Shareholder/employee's 20% 199A Deduction unless the S corporation increases the W-2 wages paid to the shareholder/employee. However, increasing the shareholder/employee's W-2 wages will increase the payroll tax liability of the S corporation and the shareholder. Therefore, careful calculations should be made before adopting this strategy.

  <u>Planning Alert!</u> If you want our firm to review the W-2 wages that your S corporation is currently paying to its shareholders in light of this 20% 199A Deduction, please contact us as soon as possible. We will be glad to evaluate your specific situation and make recommendations. **<u>Caution!</u>** The quicker you contact us on this issue, the better chance you have to take steps before the end of 2022 to increase your 20% deduction.

- **<u>Payments By A Partnership To A Partner For Services.</u>** A partner's pass-through share of **QBI** generally **"is eligible"** for the 20% 199A Deduction. Moreover, payments by the partnership to the partner that are properly classified as "distributions" neither reduce nor increase the partnership's QBI that passes through to its partners. However, the following types of payments to a partner by a partnership **do reduce** the **amount of QBI** otherwise generated by a partnership, and are also **"not eligible"** for the 20% 199A Deduction: **1)** Any amount that is a **"guaranteed payment"** paid by the partnership to the partner, or **2)** Any amount allocated or distributed by a partnership **to a partner** for services provided to the partnership where it is ultimately determined that the partner was **acting other than in** his or her capacity as a partner. **<u>Caution!</u>** It is not always clear whether specific payments to a partner will be classified as "distributions" (that generally do not reduce the amount of your 20% 199A Deduction), or alternatively fall into one of the two above-listed categories that are not eligible for the 20% 199A Deduction. Often partnerships call distributions to partners "guaranteed payments" when they are not technically guaranteed payments. Generally, guaranteed payments are payments made to partners without regard to the partnership's income. If payments to partners are merely distributions of profits or advance distributions of profits, they are probably not guaranteed payments and should not be classified as such and should not reduce the QBI of the partnership.

- **<u>250-Hour Safe Harbor For Rental Real Estate.</u>** For any business activity to generate **"Qualified Business Income" (QBI),** it must first be determined that the activity constitutes a "trade or business." For Federal income tax purposes, there has always been uncertainty whether and when a "real estate rental" activity would be considered a "trade or business." In response to that uncertainty, the IRS has released guidance that presumes a rental real estate activity is a "trade or business" **for purposes of the 20% 199A Deduction.** This presumption generally applies if the owner, employees, and independent contractors, in the aggregate, provide 250 or more hours of qualifying services with respect to the rental property during the tax year. **<u>Planning Alert!</u>** Failing to satisfy this 250-hour safe harbor only means the rental real estate activity will not be "presumed" to be a "trade or business" for purposes of the 20% 199A Deduction. For those who fail to satisfy this safe harbor, depending on the facts, it may still be possible for the owner to successfully argue that the rental real estate activity constitutes a "trade or business" under general common law principles or when the property is rented to a business controlled by the owner and in which the owner materially participates. **<u>Note!</u>** This 250-hour safe harbor contains several rules and requirements that are too lengthy to address in this letter. If you own rental real estate that is generating net rental income, feel free to call our firm and we will gladly review your specific situation and determine if your rental real estate activity is a trade or business qualifying for the 20% 199A Deduction using the 250-hour safe harbor or one of the other trade or business tests.

BE CAREFUL WITH EMPLOYEE BUSINESS EXPENSES

Un-Reimbursed Employee Business Expenses Are Not Deductible! For 2018 through 2025, "un-reimbursed" employee business expenses are not deductible at all by an employee. For example, you **may not deduct** on your income tax return any of the following business expenses **you incur as an "employee," even if the expenses are necessary for your work - Automobile expenses** (including auto mileage, vehicle depreciation); **Costs of travel, transportation, lodging and meals; Union dues** and expenses; **Work clothes and uniforms;** Otherwise qualifying **home office expenses; Dues** to a chamber of commerce; **Professional dues; Work-Related education expenses; Job search expenses; Licenses and regulatory fees; Malpractice insurance premiums; Subscriptions** to professional journals and trade magazines; and **Tools and supplies** used in your work.

An Employer's Qualified Reimbursement Of An Employee's Business Expenses Are Deductible By The Employer And Tax-Free To The Employee. Generally, employee business expenses that are reimbursed under an employer's qualified **"Accountable Reimbursement Arrangement" are deductible by the employer** (subject to the 50% limit on business meals), and the reimbursements are **not taxable to the employee.** However, reimbursements under an arrangement that is not a qualified "Accountable Reimbursement Arrangement" generally must be treated as compensation and included in the employee's W-2, and the employee would get no offsetting deduction for the business expense. **Planning Alert!** Generally, for a reimbursement arrangement to qualify as an **"Accountable Reimbursement Arrangement" - 1)** The employer must maintain a reimbursement arrangement that requires the employee to substantiate covered expenses, **2)** The reimbursement arrangement must require the return of amounts paid to the employee that are in excess of the amounts substantiated, and **3)** There must be a business connection between the reimbursement (or advance) and anticipated business expenses.

Deductions For Business Meals. Generally, only 50% of the cost of business meals (i.e., food and beverages) is deductible. However, for 2021 and 2022 otherwise deductible business food and beverages are 100% deductible if provided by a restaurant. **Planning Alert!** Therefore, a business may generally deduct 50% (100% for 2021 and 2022 if purchased from a restaurant) of the cost of meals with a business associate (e.g., a current or potential business customer, client, supplier, employee, agent, partner, professional advisor). In addition, a business may deduct 50% (100% for 2021 and 2022 if purchased from a restaurant) of the cost of food and beverages provided during a nondeductible entertainment activity with a business associate provided the food and beverages are purchased separately from the entertainment, or the cost of the food and beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts. **Caution!** If an employer reimburses an employee's deductible business food and beverage expense under an Accountable Reimbursement Arrangement, the employer could deduct 50% (100% for 2021 and 2022 if purchased from a restaurant) of the reimbursement. However, as discussed previously, an employee who is not reimbursed by the employer for the business meal would get no deduction because un-reimbursed employee business expenses are not deductible by employees (from 2018 through 2025).

Note! IRS says that **"a *taxpayer that properly applies the rules of Rev. Proc. 2019-48 may treat the meal portion of a per diem rate or allowance paid or incurred after December 31, 2020 and before January 1, 2023, as being attributable to food or beverages provided by a restaurant.*"** Therefore, if a taxpayer uses the per diem rules to reimburse or to deduct **away from home business meals,** the taxpayer does not have to document the meal was provided by a restaurant to deduct 100% of the meal cost since Notice 2021-63 presumes the meal was provided by a restaurant. This special rule only applies – **1)** to employers who reimburse employees for meals while traveling away from home on business using the per diem reimbursement amounts allowed **and 2)** to self-employed individuals who use the meal per diem amounts allowed for self-employed individuals in determining meal deductions while traveling away from home on business.

Planning Alert! The 100% deduction for otherwise deductible business food and beverages provided by a restaurant expires for restaurant meals paid or incurred after 2022.

OTHER SELECTED YEAR-END PLANNING CONSIDERATIONS FOR BUSINESSES

IRS Increases Standard Mileage Rates Effective July 1, 2022. The standard mileage rate was increased from 58.5 cents per mile (which was effective for business mileage beginning January 1, 2022) to 62.5 cents per mile effective July 1, 2022. **Planning Alert!** Be sure to keep proper records of business mileage for 2022 and future years.

Don't Overlook Simplified Accounting Methods For Certain Small Businesses. The Tax Cuts And Jobs Act (enacted in late 2017) provides the following accounting method relief provisions for businesses with **Average Gross Receipts (AGRs)** for the **Preceding Three Tax Years** of **$27 Million or Less (for 2022): 1)** Generally allows businesses to use the cash method of accounting even if the business has inventories, **2)** Allows simplified methods for accounting for inventories, **3)** Exempts businesses from applying UNICAP, and **4)** Liberalizes the availability of the completed-contract method. **Planning Alert!** The IRS has released detailed regulations and procedures to follow for taxpayers who qualify and wish to change their accounting methods in light of these new relief provisions. Please call our firm if you want us to help determine whether any of these simplified accounting methods might be available to your business.

No Deduction For Expenses Of A "Hobby". Before the 2017 Tax Cuts and Jobs Act, otherwise deductible trade or business expenses that were attributable to an activity that was *"not engaged in for profit"* (i.e., a hobby loss activity) were deductible: **1)** only as *miscellaneous itemized deductions,* and **2)** only to the extent of the activity's gross income. Since these hobby loss expenses are classified as miscellaneous itemized deductions, no deduction is allowed for these expenses ***from 2018 through 2025.*** **Planning Alert!** This makes it even more important for owners engaged in activities commonly subject to IRS scrutiny, to take all reasonable steps to demonstrate the business is operated with the intent to make a profit.

- **Three Out Of Five Year Rule Or 2 Out Of Seven Year Rule.** To reduce the potential controversy over the question of profit motive, Congress provided that if an activity generates gross income in excess of expenses in three years out of five (two years out of seven in the case of raising, showing or racing horses) the activity is presumed to be engaged in for profit. **Planning Alert!** If the IRS challenges your business losses for the first few years of activity, let us know. We may be able to make an election to extend the statute and prevent a "hobby loss" disallowance until the business has been operating for 5 years (7 years for a horse activity).

- **Protecting Against Hobby Classification.** To avoid a loss of all deductions related to a business activity that is not profitable, you should: **1)** investigate the potential profitability of a new business activity and document the investigation before entering into the business; **2)** prepare a business plan before entering into a new business activity; **3)** maintain a separate business bank account and good books and records; and **4)** document any changes made and persons consulted to help produce a profit. **Please call us if you need help with this process.**

Timing Of Year-end Bonuses Can Reduce Taxes. Employers may benefit from timing the payment of year-end bonuses. Employers using the cash method of accounting for income tax purposes can deduct bonuses when paid. This allows the employer to take the deduction in the year it produces the most tax benefit by paying the bonus in the current year or delaying payment until next year. Employers using the accrual method of accounting for income tax purposes may deduct bonuses in the year accrued assuming the bonuses can be determined by the end of the tax year and are paid within 2½ months after the end of the tax year. Accrual method employers can also push the deduction for bonuses into the following tax year by not paying the bonuses within the 2½ month time frame or by changing the bonus calculation so that the bonuses are unable to be determined by year-end.

Don't Forget To Properly Document And Provide Details For Contributions! Be sure to have the proper documentation for any contributions made during 2022 in order to deduct them against taxable income. The IRS recently denied Hobby Lobby's donations in the amount of $84.6 million because the FMV and basis of each item were not properly reported on Form 8283, when filed with its return. If you are concerned about what documentation you need to deduct a contribution, please call our firm for help.

SELECTED BUSINESS PROVISIONS THAT EXPIRED AFTER 9/30/21

Below are selected Covid-related provisions you should be aware of that expired after 9/30/21. Be sure to consider the impact of the expiration of these provisions on your business's year-end planning.

Payroll Tax Credit For Paid Sick Leave. The payroll tax credit for employers' payments to employees for qualified sick leave expired for sick leave taken after September 30, 2021.

Payroll Tax Credit For Paid Family Leave. The payroll tax credit for employers' payments to employees for qualified family leave expired for family leave taken after September 30, 2021.

Income Tax Credits For Sick Leave And Family Leave For Self-Employed Individuals. The sick leave and family credits for self-employed individuals provided by the American Rescue Plan Act (ARP) expired for qualifying sick leave or family leave days after September 30, 2021.

Employee Retention Credit Except For Recovery Startup Businesses. The employee retention credit expired for qualifying wages paid after September 30, 2021 except for qualifying wages paid by a recovery startup business for which the credit expired for wages paid after 12/31/21.

Planning Alert! If you didn't take the Employee Retention Credit on qualifying wages, you can amend Form 941 by filing Form 941-X. Generally, this form must be filed by the later of: 3 years from the date you filed your original return, or 2 years from the date you paid the tax.

Caution! The IRS recently warned employers to be aware of organizations offering to help them claim the Employee Retention Credit (ERC) when they may not actually qualify. The IRS said in the warning –

"To be eligible for the ERC, employers must have:

- *sustained a full or partial suspension of operations due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings due to COVID-19 during 2020 or the first three quarters of 2021,*
- *experienced a significant decline in gross receipts during 2020 or a decline in gross receipts during the first three quarters of 2021, or*
- *qualified as a recovery startup business for the third or fourth quarters of 2021.*

Some third parties are taking improper positions related to taxpayer eligibility for and computation of the credit. These third parties often charge large upfront fees or a fee that is contingent on the amount of the refund and may not inform taxpayers that wage deductions claimed on the business' federal income tax return must be reduced by the amount of the credit." **Note!** If your company didn't take the ERC and you believe it may qualify, please call our firm and we will review your information to determine if it does.

HIGHLIGHTS OF BUSINESS PROVISIONS THAT EXPIRED AFTER 2021

Several provisions available in 2021 have expired and are no longer available for 2022 year-end planning consideration. Below are a few of those provisions you should be aware of while planning for your 2022 tax liability.

The Increased Charitable Contribution Deduction Limitation For C Corporations. The increase in the charitable contribution deduction limitation for a C corporation's cash contributions to 25% of the corporation's taxable income in excess of all other charitable contributions for the year, expired on 12/31/21. Therefore, the limitation on a C corporation's deduction for charitable contributions after 2021 returns to 10% of taxable income. In addition, the contribution deduction limitation for a business's contribution of wholesome food inventory for the care of the ill, needy, or infants is reduced from 25% of net trade or business income to 15% of net trade or business income after 2021.

R&E Expenses No Longer Immediately Deductible - Must Be Amortized Over 5-years After 2021. The Tax Cuts and Jobs Act preserved the research credit. However, the Act requires specified research or experimental expenditures to be capitalized and amortized over a 5-year period (a 15-year period for research conducted outside the U.S., Puerto Rico, or any U.S. possession) for specified research or experimental expenditures ***paid or incurred during tax years beginning after 2021.***

Depreciation, Amortization And Depletion No Longer Added Back When Calculating Adjusted Taxable Income Under §163(j) For Taxable Years Beginning After 2021. The business interest limitation will become more restrictive in 2022 for taxpayers subject to the §163(j) business interest expense limitation since depreciation, amortization, and depletion are not added back in computing adjusted taxable income (ATI) for taxable years beginning after 2021.

SELECTED RECENT DEVELOPMENTS

The Inflation Reduction Act Of 2022. On August 16, 2022, President Biden signed the Inflation Reduction Act of 2022 (IRA). The IRA, among other things, extends and creates various energy provisions for businesses and introduces: **1)** a 15% alternative minimum tax (AMT) and **2)** a 1% excise tax, both of which apply to specific corporations beginning in 2023. We want to make you aware of this new legislation, however many of the provisions of the IRA are effective after 2022. Therefore, we believe a detailed discussion of the IRA provisions affecting businesses are beyond the scope of this year-end planning letter. However, the following are a few of the changes made by the Inflation Reduction Act which may affect your year-end planning. If you would like more details about the Inflation Reduction Act of 2022, please call our firm.

- **To Qualify For The 2022 EV Credit Final Assembly Must Occur In North America For Electric Vehicles Purchased After August 16, 2022.** The IRA made dramatic changes to the credit allowed for electric vehicles for vehicles purchased after 2022. However, the IRA also changed the requirements to obtain a credit (of up to $7,500) for an electric vehicle (EV) purchased after August 16, 2022. For EVs purchased after August 16, 2022, the final assembly of the vehicle must occur in North America to qualify for the credit. However, this "final assembly requirement" does not apply where the taxpayer entered into a written binding contract to purchase a new qualifying EV before August 16, 2022, but took possession of the EV on or after August 16, 2022.

  Planning Alert! The IRS says, *"If you purchase and take possession of a qualifying electric vehicle after August 16, 2022 and before January 1, 2023, aside from the final assembly requirement, the rules in effect before the enactment of the Inflation Reduction Act for the EV credit apply (including those involving the manufacturing caps on vehicles sold)."*

  Determining If Final Assembly Occurred In North America. The Department of Energy has provided a list of Model Year 2022 and early Model Year 2023 electric vehicles that may meet the final assembly requirement. The list can be found at https://afdc.energy.gov/laws/inflation-reduction-act. However, because some models are built in multiple locations, the IRS says there may be vehicles on the Department of Energy list that do not meet the final assembly requirement in all circumstances. Therefore, the IRS says to identify the manufacture location for a specific vehicle, we should search the vehicle identification number (VIN) of the vehicle on the VIN Decoder website for the National Highway Traffic Safety Administration (NHTSA). The NHTSA website, can be found here https://www.nhtsa.gov/vin-decoder. Also, please see https://www.irs.gov/businesses/plug-in-electric-vehicle-credit-irc-30-and-irc-30d for additional information.

- **New "Clean Vehicle Credit" For Vehicles Purchased After 2022 And Before 2033 (Code Section 30D).** Prior to the IRA, credits of up to $7,500 were provided for new "Qualified Plug-In Electric Drive Motor Vehicles" and for qualified fuel cell motor vehicles. The IRA provides a new revised credit for "Clean Vehicles" after 2022 and before 2033. A "Clean Vehicle" includes a qualified electric vehicle (EV) as outlined in Section 30D and a qualified fuel cell motor vehicle.

  Practice Alert! These credits for Clean Vehicles **apply to personal-use vehicles and to business vehicles. However, the new Clean Vehicle credit for commercial vehicles discussed below may only be used for depreciable property and may be less restrictive than these general "Clean Vehicle" credits.**

  Elimination Of Manufacture's Limitation. The IRA removes the disallowance of the EV credit when the number of electric vehicles manufactured by a manufacturer exceeds 200,000, effective **for vehicles sold after December 31, 2022.**

  Practice Alert! This is a significant change! The EV credits for Tesla vehicles expired for vehicles acquired after 2019. The credits for GM vehicles expired for vehicles acquired after March 31, 2020. **Note!** Individuals purchasing vehicles manufactured by Tesla or GM may wish to wait until 2023 to acquire a qualifying vehicle. However, please remember that vehicles purchased after 2022 must meet the new requirements under the IRA, discussed below, to qualify for either this Clean Vehicle Credit or the Clean Vehicle Credit for Commercial Vehicles discussed later.

  Amount Of EV Credit. Taxpayers are allowed a refundable credit for a qualifying EV. The **maximum credit amount is $7,500 for new EVs.** The vehicle must have a minimum battery capacity of seven kilowatt hours; be manufactured primarily for use on public streets, roads, and highways; have at least 4 wheels, and have a GVWR rating of less than 14,000 lbs. The credit is calculated as follows:

  - **$3,750 credit** if at least **40% of the critical minerals contained in the battery** are extracted or processed in the U.S., in a country with which the U.S. has a free trade agreement in effect, or are recycled in North America. This 40% requirement applies to vehicles placed in service after the IRS issues guidance concerning the critical minerals and battery component requirements. The 40% critical minerals requirement is increased as follows – to 50% for EVS placed in service in 2024; 60% for 2025; 70% for 2026; and 80% after 2026.

  - **$3,750 additional credit** if at **least 50%** of the battery components are **manufactured or assembled in North America.** This 50% requirement applies to vehicles placed in service after the IRS issues guidance concerning the critical minerals and battery component requirements. The 50% battery component requirement is increased as follows – to 60% for EVS placed in service in 2024 & 2025; 70% for 2026; 80% for 2027; 90% for 2028 and 100% after 2028.

  Retail Price Limitation. No credit will be allowed for a new vehicle if the manufacturer's suggested retail price of the vehicle exceeds – **$80,000** for SUVs, pickups, and vans; and **$55,000** for other vehicles.

  AGI Limitation. No credit will be allowed for a new vehicle if the **lesser of** current or prior year MAGI is more than **$300,000** for joint filers, **$225,000** for head of households, and **$150,000** for others. MAGI means AGI increased by any amount excluded from gross income under §911 (foreign earned income and housing exclusions), §931 (income from Guam, American Samoa, or the Northern Mariana Islands), and §933 (income from Puerto Rico).

Other Requirements. In addition, to the above requirements, the final assembly of the vehicle must occur in North America and the vehicle's VIN must be included in the taxpayer's return.

- **Credit For Qualified Commercial Clean Vehicles Acquired And Placed In Service After 2022 And Before 2033 (Code Section 45W).** The IRA provides an EV credit for depreciable commercial electric vehicles acquired and placed in service after 2022. **Planning Alert!** The AGI limitations, the limitation on the cost of the vehicle, and the requirement that final assembly of the vehicle must occur in North America that apply to the Clean Vehicle credit under Section 30D discussed above do not apply to the Clean Vehicle Credit for commercial vehicles. Businesses planning on acquiring electric vehicles should consider this new 2023 credit for commercial EVs and the Clean Vehicle Credit discussed above before acquiring an electric vehicle in 2022. It may pay to wait until 2023.

  Credit Amount. The credit is the **lesser of 1)** 30% of the vehicle's basis or **2)** the incremental cost of the vehicle if the vehicle is 100% electric. The 30% credit amount is reduced to 15% if the vehicle has a gasoline or diesel component (i.e., if a hybrid). The **"incremental cost"** means the excess of the purchase price of the vehicle over the price of a comparable gas- or diesel-powered vehicle. Section 45W says –*"the term 'comparable vehicle' means, with respect to any qualified commercial clean vehicle, any vehicle which is powered solely by a gasoline or diesel internal combustion engine and which is comparable in size and use to such vehicle."* The **maximum credit allowed** is **$7,500** where the vehicle has a **GVWR of less than 14,000 pounds** and **$40,000** for a vehicle with a **GVWR of 14,000 pounds or more.**

  Qualified Commercial Clean Vehicle. A "Qualified Commercial Clean Vehicle" is a vehicle that **1)** is depreciable property; **2)** is acquired for use or lease by the taxpayer, and not for resale; **3)** is manufactured for use on public streets, roads, and highways, or is "mobile machinery" as defined in §4053(8) (including vehicles that are not designed to perform a function of transporting a load over the public highways); **4)** has a battery capacity of not less than 15 kilowatt hours (7 kilowatt hours for vehicles weighing less than 14,000 pounds) and is charged by an external electricity source; and **5)** is made by a qualified manufacturer that has a written agreement with the Treasury Department and provides reports to the Treasury Department. Qualified commercial fuel cell vehicles are also eligible for the credit.

  Other Requirements. The credit for a Qualified Commercial Clean Vehicle is not allowed if the taxpayer is allowed a Clean Vehicle Credit under Section 30D as discussed above. As with other clean vehicle credits, a VIN is required on returns claiming the credit. **Planning Alert!** It seems a taxpayer that acquires a new vehicle qualifying for either the regular clean vehicle credit or this commercial clean vehicle credit may choose to take the largest of the two credits.

  IRS Guidance. The IRA directs the IRS to issue guidance to implement the credit including guidance for determining the incremental costs of a commercial clean vehicle.

The IRS Provides Retroactive Late Filing Penalty Relief For 2019 And 2020. The American Institute of Certified Public Accountants (AICPA) and others have been requesting for some time that the IRS provide penalty relief for 2019 and 2020 returns. Many of the penalties levied by the IRS for late-filing or for non-filing were in error and were assessed simply because the IRS had not timely processed the return or in some cases, had not processed the return at all.

On August 24, 2022, the IRS issued Notice 2022-36 providing retroactive blanket relief from such penalties for certain 2019 and 2020 returns that were **filed on or before September 30, 2022 (on or before February 15, 2023, for individuals and businesses located in Florida, North Carolina, or South Carolina).** In addition, limited relief is provided for certain information returns. **Note!** The IRS says that for those who have already paid late-filing penalties, the IRS will automatically refund or credit the penalty amounts without any need for taxpayers to request relief. The IRS estimates that these penalty waivers will benefit 1.6 million taxpayers who have already paid the penalties and these taxpayers will receive refunds totaling more than $1.2 billion. The Service said the refunds would be received by the end of September. The relief applies to most 1040 series forms, form 1041, most 1120 series forms, form 1065, form 990-PF, form 990-T, form 1120-S, form 1066, form 5471, form 5472, form 3520, and form 3520-A. There is also a reduction in some information return (e.g., form 1099) filing penalties. **If you or your business has been assessed a late filing penalty for any of these returns for 2019 and/or 2020 and the IRS has not refunded or abated the penalty, please contact our office.**

National Taxpayer Advocate Says Waiver Will Not Affect Taxpayers' Use Of First Time Abate Waiver. In a blog dated August 24, 2022, National Taxpayer Advocate Erin Collins said the following concerning the penalty relief provided by Notice 2022-36 – *"This unprecedented program is conceptualized as broad administrative penalty relief and is designed specifically to meet the exigent circumstances of the pandemic. The relief does not fall into the category of either the First Time Abatement (FTA) or reasonable cause relief. FTA is an administrative waiver that provides otherwise-compliant taxpayers relief from penalties if certain criteria are met. The policy behind FTA is to reward taxpayers for having a clean compliance history, while recognizing that taxpayers occasionally make a mistake. The reasonable cause defense to the assertion of penalties, which is defined in the Internal Revenue Code, generally is based on the taxpayer's facts and circumstances in determining if a taxpayer exercised ordinary business care and prudence. The current penalty relief program will neither preclude taxpayers from receiving FTA for the next three years nor require justification, as would be the case with a request for reasonable cause. It is simply a favorable grant of administrative forbearance that the IRS is providing to benefit taxpayers and to address its own administrative burdens."*

Returns Extended To October 17, 2022 Are Now Due February 15, 2023 For Florida, South Carolina, And North Carolina Residents And Businesses. On October 5, 2022 the IRS announced that individuals and businesses in North Carolina and South Carolina have until February 15, 2023, to file various federal individual and business tax returns for 2021. The IRS made a similar announcement on September 29 for Florida residents and businesses. In addition, individuals and businesses in these states may deduct losses from Hurricane Ian since Ian has been declared a federal disaster. **Planning Alert!** You have the option to deduct any Hurricane Ian loss not covered by insurance on either your 2021 income tax return or on your 2022 income tax return. You should generally take the deduction on the return which produces the greatest tax benefit. If you are a resident or have a business in one of these states, please call our firm and we will help you decide if it is better to take any loss on your 2021 or 2022 return. In addition, we will gladly provide more details concerning Hurricane Ian relief. Also, more detailed information concerning the Federal Hurricane Ian relief provided for Florida, South Carolina, and North Carolina can be found at https://www.irs.gov/newsroom/help-for-victims-of-hurricane-ian.

FINAL COMMENTS

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our Firm closely monitors these changes. In addition, **please call us before implementing any planning idea discussed in this letter, or if you need additional information concerning any item mentioned in this letter.** We will gladly assist you. **Note!** The information contained in this material should not be relied upon without an independent, professional analysis of how any of the items discussed may apply to a specific situation.

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