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The Winds of Change

What You Need to Know about the New Tax Climate

Barnes Dennig
Signature Tax Event

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11.9.21 – Barnes Dennig Signature Tax Event

Optimizing the Sale of a Business

Strategies to Maximize Value & Minimize Tax

Andy Bertke
Scott Cress
Reid Schlotterbeck

Buying and Selling a Business

- **What can be sold? (focus on selling, if buying do the opposite)**
  - **Assets** in the business
  - **Stock** of the business
- **Hybrid Transactions:**
  - **Personal Goodwill** – an asset outside the business
    - Avoids double taxation where seller is a C-corp
  - **338(h)(10) and 336(e) -** seller sells assets and buyer buys stock; election to treat as an asset sale
    - Used to allow buyer to acquire the legal entity for non-transferable assets
  - **F – Reorganization** - designed to be an asset sale, legal entity purchase
    - Similar to 338(h)(10) but seller can defer a portion of the gain with rollover equity

Barnes Dennig Insight:

For a given asset sale there is generally a gross up in sale price in which the buyer will pay more for the for the tax benefit it receives from buying assets as opposed to buying stock. Also, the reverse may happen in a stock purchase. (0% to 15% discount is typical). State taxes also apply if the business or the owner is domiciled in a state with a corporate or individual income tax.

Buying and Selling a Business - Other Transactions

- ESOP – sale of stock to employees (retirement plan)
  - Corporations
  - S-corporations
- Redemptions – sale of stock back to the company
  - Watch out for section 302(b) if family members still have ownership

Barnes Dennig Insight:

Entity selection upon formation or changing entity type is extremely important; it not only affects the tax consequences during the operating life of the company, but perhaps more importantly it may have a profound affect on the taxation of when the company is sold.

Rollovers, Exclusions, and Deferrals

- **Section 1042** – Tax-free rollover from the sale of a business (stock) to an ESOP
  - Tax deferral by rolling over sale proceeds into qualified replacement property
  - May be a permanent deferral upon the death of the owner and basis step up
- **Section 1202** – Capital gains exclusions on the sale of business (stock)
  - Avoid paying tax on 50% - 100% of gain on sale of Qualified Small Business Stock (QSBS)
- **Section 1045** – The seller can roll over taxable gains of QSBS into another QSBS
  - Defer the recognition until the newly-acquired stock is sold – or potentially use Section 1202

Barnes Dennig Insight:

To date, although changes in the capital gains rates have been discussed in the Bill circulating though Congress, these code sections of statutory grace appear not to be threatened to be amended or repealed.

Gift/Estate Tax Law Changes – Never Mind?

- Build Back Better Framework included:
  - Reductions in unified credit; from $11.7M to (approx.) $5M;
  - Eliminated the "step-up" in basis that occurs at death;
  - Taxed unrealized gains at death; or
  - Eliminating discounts on non-operating entities; or
  - Some combination of the above
- To the surprise of many, language in the latest proposal contains none of the above provisions
- Worth noting:
  - The current $11.7M estate/gift tax exclusion already set to cut in half beginning 2026
  - In the past, Congress has reinserted previously-drafted proposed legislation in the waning hours

Estate and Trust Updates

- 2022 estate and gift tax lifetime exclusion = $12,060,000 per individual
  - Potential for legislative changes to decrease
- 2022 gift tax annual exclusion = $16,000 per donee
- Planning strategies
  - Spousal Limited Access Trust (SLAT)
  - Intentionally Defective Grantor Trust (IDGT)
  - Grantor Retained Annuity Trust (GRAT)
  - Grantor trusts are on Washington’s radar to be changed…no current legislation
- Build Back Better Act Potential Changes for Regarded Trusts
  - 5% or 8% surtax – 5% applies at income over $200k, and 8% kicks in at $500k

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State and Local Tax

State Tax Nexus

What You Need to Know about Nexus

(it’s a lot more than e-commerce)

Dave Walls
Ryan Lauer

What is Nexus?

- “Nexus” is that minimum level of business activity or connection with a state, which allows that state to subject an out-of-state business to its tax laws.

- There are different standards to create nexus for state sales tax, state income tax or state gross receipts tax.

Sales Tax Nexus

- Sales Tax Nexus:

  US Supreme Court case involving Wayfair: Physical presence is no longer necessary to create sales tax nexus in a state.

  The court said that sales tax nexus is created if a business has either $100,000 in sales or 200 transactions in a state (South Dakota). This threshold is now a widely adopted nexus standard across the US.

  Varying approach by state for calculation of sales tax nexus threshold:

  -Calendar year sales

  -Quarterly basis

  -Rolling monthly calculation

Sales Tax Compliance

- Sales Tax Compliance:
  Example: $100,000 in sales in Indiana

Items to Consider….

- When was the threshold met?
- How far back to filings need to occur?
- Consider Voluntary Disclosure Agreement (VDA) to minimize penalties
- When to register as a vendor?
- Should you charge sales tax or collect exemption certificates?
- Do you have the staff and software to be able to file these additional returns, or should you consider outsourcing this function?

Gross Receipts Tax Nexus

- Some current states with a gross receipts tax: DE, NV, OH, OR, TN, TX and WA

- These taxes are not based on income and the nexus threshold is normally based upon a “factor presence” standard
  - Threshold varies by state
  - Common Threshold: $500,000 in sales, $50,000 in payroll or $50,000 in property

- No physical presence is necessary to create nexus in these states

Income/Franchise Tax Nexus

- Some states have a “factor presence” nexus standard including AL, CA, CO, CT, MI, NY and TN

- Common threshold for Nexus: $500,000 in sales, $50,000 in payroll, $50,000 in property

- No physical presence is necessary to create nexus in these states
  - Some protections still exist for businesses selling tangible personal property into the state

Physical vs. Economic Presence Nexus

- States are evolving from a physical presence nexus standard for all state taxes to an economic presence standard

- As a result, states are aggressively looking to tax businesses deriving income within their state without a physical presence (e.g., OH CAT on out-of-state business making sales into OH)

State Nexus Items to Consider

- Different nexus standards for sales tax, gross receipts tax and income tax
- Each state has its own standards for determining nexus
- Consider a periodic review of state tax filing requirements
  - Has your business expanded to new states in recent years?
  - Do you now have remote workers?
  - Are you using independent contractors?

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Employee Retention Tax Credit

Is your business eligible?

When, and for how much?

Andy Bertke
Ryan Lauer

Does My Business Qualify for the Employee Retention Tax Credit?

1. Determine if company is an eligible employer
2. Determine if employer paid qualified wages
3. Calculate the amount of the credit
4. Claim the credit

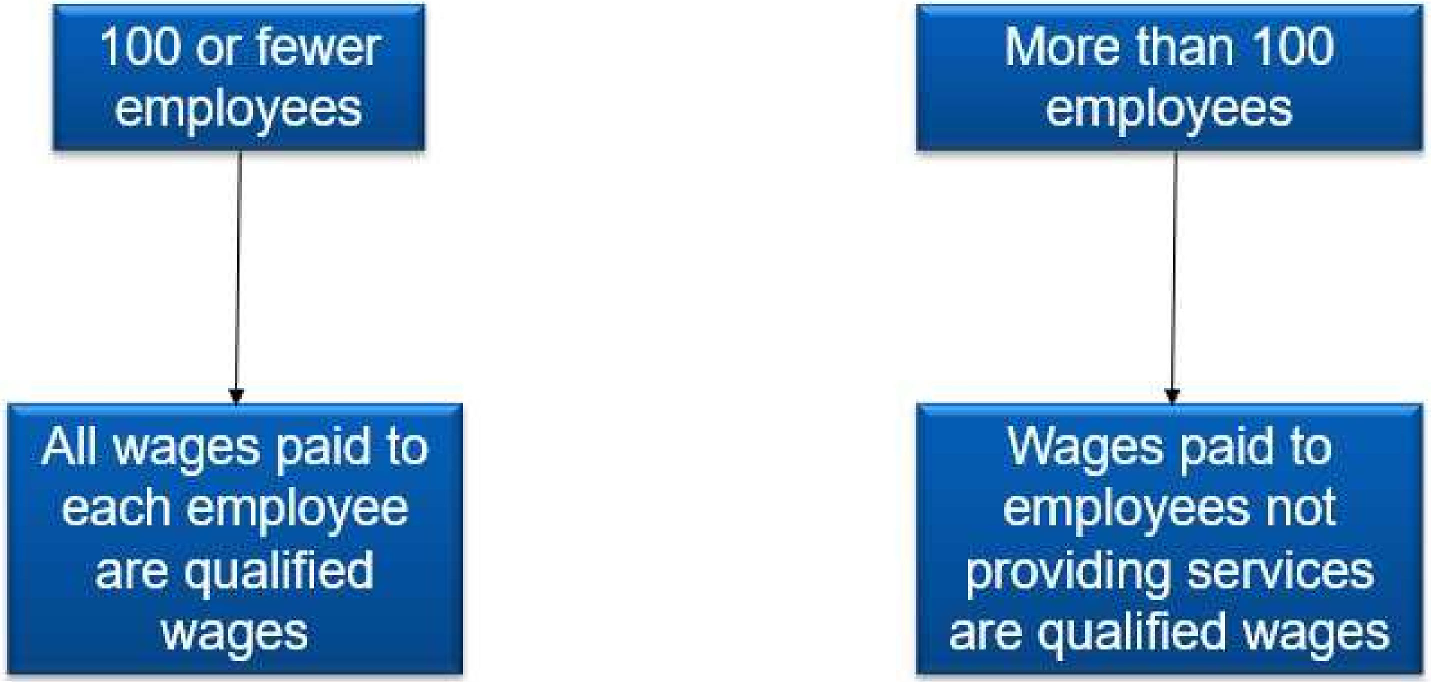
Step 1: Who is an eligible employer for 2020?

- Fully or partially suspended operations during any calendar quarter in 2020 due to orders from an appropriate government authority limiting commerce, travel or group meetings due to COVID 19, **OR**
- 2020 Gross Receipts are less than 50% of gross receipts compared to same calendar quarter in 2019
- Other considerations:
  - Cannot double dip with FFCRA, and other payroll tax credits (ex.- R&D and WOTC)
  - Controlled groups are considered a single employer
- CAA Update: An employer is eligible even if it had received a PPP loan.
  - Cannot double-dip with the PPP so any wages for which a taxpayer claims an ERC are NOT eligible to be forgiven as part of the PPP process
  - Can elect to not include wages for ERC to have them qualify for PPP forgiveness
  - Interplay of calculations for PPP loan forgiveness and employers that can now claim ERC

Fully or Partially Suspended Operations

- Shutdowns are possible for Essential Businesses, if…
  - its suppliers cannot deliver critical supplies or materials to the employer if the supplier's operations are suspended by a government order and the Essential Business is not able to perform its operations.
  - the employer operates both essential and non-essential businesses and the non-essential business's operations are fully or partially suspended, and that business(s) is more than a nominal portion of the employer.
  - the employer operates in multiple locations and the operations are fully or partially suspended in a jurisdiction where the employer is operating.

Step 2 – Did the employer pay qualified wages?



Step 3 – Calculate the Credit

- Qualified wages must be paid after March 12, 2020, and before January 1, 2021
- Health care plan expenses will be considered qualified wages

  This includes pre-tax health care expense paid for furloughed employees
- Maximum of $10,000 qualified wages per employee for a potential $5,000 credit per employee for all of 2020

Qualified Wages × 50% = Employee Retention Credit

- Timeframe?

  If business qualified due to shutdown, only count wages paid while the business was shut down for an employer with over 100 FTEs, entire quarter for 100 or less FTEs.

  If business qualified due to reduction in gross receipts, count wages paid in quarter where reduction occurred. Wages continue to be eligible until the END of the quarter in which gross receipts are at least 80% of the same quarter in 2019.

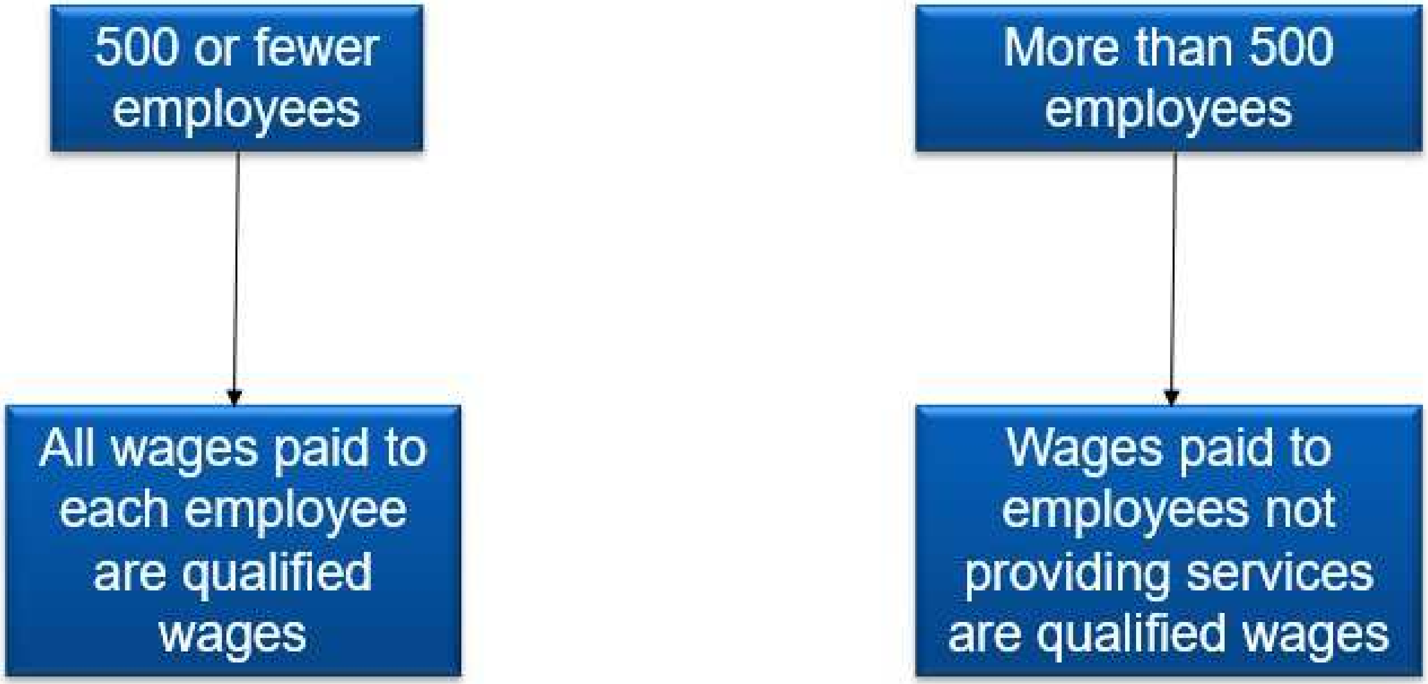
Step 4 – Claim the Credit

- After calculations are prepared a deliverable showing eligible wages and the credit amount are provided to the payroll tax return preparer
- Employers, or their payroll provider use Form 941X to claim the refundable credit

Step 1- ERC 2021- Who is an eligible employer?

- Fully or partially suspended operations during any quarter in 2021 due to orders from an appropriate government authority limiting commerce, travel or group meetings due to COVID 19, **OR**
- **20%** reduction in gross receipts compared to same calendar quarter in 2019
  - Also, an option to compare immediately preceding calendar quarter to the corresponding quarter in 2019. Ex. If Q1 2021 doesn't meet test, comparing Q4 2020 with Q4 of 2019. If there is a 20% decrease in gross receipts, then Q1 2021 would be eligible.
- Other considerations
  - Cannot double-dip with FFCRA and other payroll tax credit
  - Cannot double-dip with PPP loan forgiveness funds used for payroll
  - Controlled groups are considered a single employer

Step 2 - ERC 2021 – Did the employer pay qualified wages?



Step 3 - ERC 2021 – Calculate the Credit

- Qualified wages between January 1, 2021- December 31, 2021
  - If business qualified due to shutdown, only count wages paid when the business was shut down for employers with over 500 FTEs
  - If business qualified due to reduction in gross receipts, count wages paid in quarter where reduction occurred. Wages continue to be eligible until the END of the quarter in which gross receipts are at least 80% of the same quarter in 2019.
- Healthcare plan expenses will be considered qualified wages
  - This includes healthcare expense paid for furloughed employees
- Maximum of $10,000 qualified wages per employee <u>PER QUARTER</u> for a potential $28,000 credit per employee for 2021
  - NOTE: potential sunset of the ERTC after September 30, 2021

Qualified Wages × 70% = Employee Retention Credit

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Investment Strategies and Tax Implications

Barnes Dennig Wealth Management

Beth Germann
Mark Hamad

Tax planning with withdrawal strategies

- If I could turn back time…
  - Complaint of retired “savers” subject to RMDs
  - Tax planning can alleviate future issues

- Marginal tax rate planning
  - Harvesting income
    - Up to 12% marginal rate MFJ taxable income $80,250
    - Up to 24% rate MFJ $326,600
  - Defer income / increase deductions
    - 32% up to $414,700
    - 35% up to $622,050
    - 37% above $622,051

Leaving accounts until RMD

- Taxpayer and spouse - retiring at 62
  - 401(k) traditional - $1.5M at retirement
  - Value at RMD - $3.3M (8% return)
  - RMD alone in year one ~$120K
- Consider “micro-conversions”
  - Fill the 12% bucket each year
  - Value of the accounts are the same, if you can use funds outside of the account to pay conversion taxes
  - But now have access to a not taxable (Roth) bucket – meaning the taxable RMD differential is at a marginal rate of 22% or possibly higher

Making predictions

- What are we (almost) certain about
  - Benefit of tax-deferred compounding growth
  - Taxes are going to fluctuate, and likely go up
  - Taxpayers need to be prepared to fund their own retirement expense
  - That circumstances will change!

- Unexpected certainties
  - Inherited IRAs
  - Timing of…..retirement, expenses
  - Market downfalls and fluctuations
  - Changing tax environment

Retirement Plans

- The Build Back Better Act targets high-income taxpayers with over $10 million in retirement plan balances (value determined as of the close of the previous year)

- Who is considered a high-income taxpayer?

Single:	$400K
HOH:	$425K
MFJ:	$450K

- Note: These changes would only impact taxpayers with over $10M balances **AND** over the income threshold. The changes would NOT apply to taxpayers below these limits.

Proposals

- #1 – Prohibits individuals from making Traditional and/or Roth IRA contributions if total aggregate IRA and defined contribution account (401k, 403b and 457b) balances exceed $10 million.

- #2 – Imposes a new Required Minimum Distribution (RMD) rule:

  Required to distribute 50% of account balance over $10 million

  To the extent aggregate balances exceed $20 million, the excess must be distributed from Roth designated accounts up the lesser of:

  1. The amount needed to bring the aggregate balances down to $20 million
  2. The aggregate balance in all Roth accounts

Examples

- **Example #1** – Taxpayer A has an IRA and 401(k) aggregate account balance of $9,995,000. Taxpayer A would be permitted to contribute $5,000.

- **Example #2** – Taxpayer B has an IRA and 401(k) aggregate account balance of $11,000,000. Taxpayer B's new RMD is $500,000 (50% of the excess over $10M).

- **Example #3** – Taxpayer C has an IRA and 401(k) aggregate account balance of $20,500,000. If Taxpayer C had $500,000 of Roth amounts, then Taxpayer C's new RMD would be $5,500,000 ($500K Roth + 50% of the excess over $10M).

  If Taxpayer C had Roth amounts less than $500,000, then those Roth amounts must be distributed in full, plus the new 50% of excess over $10 million.

Proposals (continued)

- **Roth conversions**: Those same high-income taxpayers would no longer be eligible for Roth IRA conversions. Eliminates:
  - Traditional IRA to Roth IRA rollovers
  - "Back door" nondeductible Traditional IRA contributions
- **Investments**: Proposals would prohibit IRAs from holding unconventional assets or alternative investments through accredited investor status
  - For IRAs already holding these investments, there will be a two-year transition period
- All changes effective starting in 2029

What Should I Do Right Now?

- Find out your retirement account balances
- Determine the breakdown between Traditional vs. Roth amounts
- Income management will more important than ever
- Consider Traditional to Roth IRA conversions in 2021
    - Include income in 2021 at possibly lower rates
    - No income recognized in 2022 or future years
    - No regular RMDs imposed on Roth IRAs during the owner's life
    - Tax-free growth

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New Tax Laws

What’s Coming, What’s Going, and When

Christina Sensenbrenner
Laura Hunter

Bipartisan Infrastructure Bill

- **Awaiting President Biden's Signature**

- Total cost of $1.2 trillion over eight years, $550 billion in new spending
  - Roads, bridges, and other much needed infrastructure fix-ups
  - Electric grid and power structures
  - Rail services, broadband, water infrastructure, environmental remediation
  - Climate resiliency – protection against fires, flooding, etc.
  - Airports, port infrastructure
  - Transportation safety programs
  - Electric vehicles, zero-emission buses, ferries
  - Modernize public transit

Bipartisan Infrastructure Bill

- Tax Offsets –
  - Federal highway-related excise taxes extended through September 30, 2028
  - New cryptocurrency information reporting requirement
  - Reinstatement and modification of Superfund excise taxes on chemicals
  - Extension of interest smoothing options for defined benefit plans
  - Modifications to private activity bond provisions
  - Sunsetting the COVID-19 ERTC after September 30, 2021

- Non-Tax Offsets –
  - Rescinding unused funding from COVID-19 relief bills
  - Delaying change in Medicare prescription drugs rebate rules
  - Revenue from future spectrum auction sales and other government assets
  - Increased economic growth from infrastructure improvements

Build Back Better Framework Agreement

- Announced on October 28, 2021
- Outlines spending provisions totaling $1.85 trillion over 10 years
- Revenue offsets totaling nearly $2 trillion over the same period

Build Back Better – Spending Provisions

- Universal preschool for 3&4-year-olds & limit on childcare costs
- 1-year extension for expanded Child Tax Credit & Earned Income Tax Credit
- Tax Credits and Incentives for clean energy & new domestic supply chains
- Extend expanded Affordable Care Act (ACA) premium tax credits through 2025
- Establishes a hearing benefit in Medicare (does not include dental or vision)
- Investments in affordable housing, higher education, and workforce training
- Improving immigration system

Build Back Better – Revenue Provisions

- 15% Corporate Minimum Tax on Large Corporations
  - Large Corporation defined as over $1 billion in profits (book)
- 1% surcharge on corporate stock buybacks
- Corporate International Reform
  - Global Minimum Tax – 15%, country-by-country
  - Penalty Rate for foreign corporations in non-compliant countries (Base Erosion and Anti-Abuse Tax)
- Additional 5% tax rate on AGI above $10 million, additional 3% above $25 million

Build Back Better – Revenue Provisions

- Expanded application of Net Investment Income Tax
  - 3.8% NIIT to include trade or business income for taxpayers making over $400,000 ($500k MFJ)
- Limitation on excess business losses
  - Made permanent
- “Mega” IRA provision (added back)
  - Prevent contributions and require distributions on accounts exceeding $10 million
  - New effective date of 2029
  - Backdoor Roth contributions eliminated in 2022
- Pared-back proposal for top 10 drugs

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Build Back Better – Other Items

- "Tax Gap" Provisions
  - Call to increase the IRS' enforcement budget to close the "tax gap"
- Includes modifications to common control rules
- November 3rd – Pelosi Revised Bill
  - Added paid family and medical leave back (four weeks)
  - Increased the state and local tax deduction to $80,000 from $10,000 cap through 2030. Afterward returning to $10,000.
  - Potential to be a deal breaker?

Build Back Better – Other Items

- Other omitted provisions –
  - Changes to capital gains rates
  - Increased tax brackets – corporate and individual
  - Changes to the §199A deduction
  - Changes to estate and gift tax rules and the grantor trust rules
  - Changes to the tax treatment of carried interest
  - Significant changes to the partnership tax rules
  - Lower prescription drug costs
  - Free community college

Expiring Provisions - Business

- 100% deduction of food or beverages provided by a restaurant during calendar years 2021 and 2022.
  - Will return to 50% after calendar year 2022
- §163(j) – Limit on Business Interest Expense Deduction
  - For taxable years beginning after 2021, deductions for depreciation, amortization, or depletion are not taken into account in calculating ATI (adjusted taxable income)
- Bonus Depreciation Phase Out
  - 100% placed in service before January 1st, 2023
  - 80% in 2023, 60% in 2024, 40% in 2025, and 20% in 2026
  - 0% bonus depreciation rate in 2027 and later years

Expiring Provisions - Individual

- Above the line Charitable Deduction eliminated after 2021
  - Currently $300 for cash donations during 2021 ($600 for MFJ)
- $10,000 cap on SALT deductions – currently set to expire after 2025
- 20% Section 199A Qualified Business Income Deduction
  - Set to expire after December 31st, 2025
- Estate Tax Exemption Amount
  - Current amount is set to expire after December 31, 2025
  - After expiration would revert to $5 million for an individual taxpayer

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International Outlook

Updates

Ellen Juram
Michael O’Hara

International Tax Updates

- Global minimum tax: Build Back Better framework will impose a 15% minimum tax on the corporate profits that large corporations – those with over $1 billion in profits – reports to shareholders.
    - Includes foreign-owned US corporations
- OECD minimum tax: 136 countries, as part of the Organization for Economic Co-operation and Development (OECD), recently agreed on a 15% global corporate minimum tax. Consistent with that agreement, the framework would adopt a 15% country-by-country minimum tax of foreign profits of US corporations.
    - Global Intangible Low-Taxed Income (GILTI) modifications
    - Foreign Tax Credit modifications

International Tax Updates

- Global Intangible Low Tax Income

  Current Rules:

  Minimum tax on GILTI is 10.5%

  Net deemed tangible income return is 10% of the qualified business assets

  GILTI is computed by combining all countries (allows for offsets)

  Excess foreign taxes in the GILTI basket do not carry over

  Proposed Rules:

  Increases the minimum tax to15%

  Net deemed tangible income return is 5% of the qualified business assets

  GILTI is computed on a country-by-country determination

  Excess foreign taxes in the GILTI basket would carry over for 5 years for tax years beginning after December 31, 2022, and before January 1, 2031. For tax years beginning after December 31, 2030, the carryforward period for the GILTI basket would be 10 years.

Reporting Updates

- Pass-through entities with international operations

  New Forms

  K-2: Partners’ Distributive Share Items – International (19-page form)

  K-3: Partner’s Share of Income, Deductions, Credits, etc. - International (20-page form)

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Questions?

Use the chat feature to ask our presenters.