DHG

TAX

YEAR-END TAX PLANNING

DECEMBER 2021

TAX

As the tax year draws to a close for many, taxpayers will naturally be evaluating their tax situation year to date and contemplating what additional steps they may take to positively impact their tax situation. This letter highlights some areas you may want to consider as you focus on your year-end planning process. We anticipate this letter may raise some questions, and we are here to help. We are hopeful that this letter will spark some ideas and begin to lay the groundwork for identifying and evaluating options specific to your circumstances and objectives with your DHG tax advisor.

We look forward to working with you in meeting the challenges of today and planning for the successes of tomorrow.

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Individuals

MORTGAGE INTEREST

The recent events of 2020 and 2021 have resulted in individuals spending significantly more time at home and, in many instances, utilizing their homes in different ways, such as for work and school. For many, these changes may become part of the new normal as businesses and employees adapt to incorporate recent virtual work capabilities on a more permanent basis. In conjunction with this evolution, a person or family may consider relocating to a new principal residence that will better meet these needs.

Individuals deciding to make the move will need to factor in the potential tax implications. One potential tax impact of a move is a potential reduction in the amount of deductible mortgage interest. The Tax Cuts and Jobs Act (TCJA) lowered the maximum total debt on which home mortgage interest may be deducted from $1 million to $750,000 (for taxpayers other than married individuals filing separately (MFS)).

While these changes became effective in the 2018 tax year, a grandfathering provision allowed many taxpayers whose mortgage debts were all incurred prior to December 15, 2017, to continue to apply the prior limitation in determining deductible home mortgage interest. As a result, taxpayers selling a home and purchasing a new home in 2021 may find themselves subject to this lower limitation for the first time in 2021.

Due to the unusual events of 2020 and 2021, many taxpayers may have decided to access their home equity to provide for cash flow needs. To the extent that additional cash obtained through either a refinance or a home equity loan was not used to make significant improvements to the residence, no deduction for mortgage interest is allowed under current post-TCJA rules. However, if the taxpayer has utilized the funds for other tax-deductible purposes, such as funding the operations of their business, the interest may be deductible elsewhere on their return.

To the extent proceeds were used to make significant improvements to the home, the interest will still qualify as acquisition interest subject to the overall debt limitation of $750,000 ($375,000 MFS).

SALE OF PRINCIPAL RESIDENCE

Generally, gain from the sale of real property is taxable. However, taxpayers may be able to exclude up to $250,000 of gain per individual if the taxpayer has both owned and used the property as their principal residence for two years within the immediately preceding five-year period ending on the date of sale. This home sale exclusion will not apply if the individual has excluded gain under this provision on the sale of another residence within the two years immediately preceding the sale. In the case of married individuals, a gain of up to $500,000 in total may be excluded if both spouses meet the requirements.

In the case of individuals failing to meet the ownership and use requirements, a special rule is provided to allow a pro-rata gain exclusion if the sale is due to a change in place of employment, health or unforeseen circumstances to the extent provided in the regulations. The regulations provide more detailed criteria for each of these categories, and application of the pro-rata exclusion is made on a basis of facts and circumstances. A sale due solely to an individual's preference for a different residence or an improvement in financial circumstances will not meet the unforeseen circumstances criteria. Individuals not meeting the ownership and use requirements who have relocated during 2021 for reasons other than preference or financial improvements may wish to consult with their tax advisor on whether a partial exclusion may apply to the sale of their residence.

STATE AND LOCAL TAXES

Under the TCJA, an individual's deduction for state and local taxes (SALT) is generally capped at $10,000. However, this cap does not apply to property taxes on property that is used in a trade or business or that is held for production of income purposes. The term "income" includes not merely income of the taxable year but also encompasses gains from the disposition of property other than personal use property. Individuals holding property, such as raw land, solely for investment purposes will want to segregate the property taxes associated with these properties and discuss with their tax advisor whether these taxes might be excluded from the general SALT cap.

Another planning idea to consider is the election to capitalize certain carrying costs, such as property taxes. Under this election, the property taxes paid during the year would increase the basis in the property, thereby reducing future gains recognized upon disposition. Individuals who would not benefit from a deduction of their property taxes due to the SALT cap will want to discuss this election with their tax advisor as a potential avenue for preserving the tax benefit.

Owners of pass-through entities (S-corporations and partnerships) may be able to increase the federal benefit resulting from payment of state taxes by making state pass-through tax elections. Many states have enacted legislation allowing pass-through businesses to choose to be subject to state income tax at the entity level instead of the shareholder or partner level. According to a recently issued IRS Notice, state taxation at the entity level will generally result in the business being able to reduce the net business income taxable to its shareholders or partners on their K-1 in the year of payment by the entity. The availability, requirements and non-federal impacts of these elections will vary on a state-by-state basis. Taxpayers considering this planning technique should work with their tax advisor to ensure they understand the full picture before making an election.

It is worth noting that the Build Back Better Act (BBBA), as passed by the House, includes a provision that would increase the SALT cap to $80,000 for tax year 2021. While the future of the BBBA and its current provisions are currently uncertain, individuals may want to proactively discuss this possible change with their tax advisor to identify any potential opportunities associated with the timing of state estimated tax payments.

HOME OFFICE

The unusual circumstances of the past two years have resulted in more people working from home. While the TCJA eliminated home office deductions for employees until after 2025, self-employed individuals may still be able to recognize an allocable portion of their home office expenses. In order to do so, the home office must be used exclusively and on a regular basis as the principal place of business or to meet with clients or customers in the normal course of business. A home office deduction is also allowed in the case of a separate structure from the residence that is exclusively used regularly in connection with the business.

The exclusive use test can be very restrictive, meaning more than just extensive use. Accordingly, individuals intending to claim this deduction will want to ensure they designate a specific area within their home to be used as the "office space" and that the designated space is not then used for any other purpose.

Generally, two tests are applied in determining whether a home office qualifies as the taxpayer's principal place of business: 1) the relative importance of the activities performed at each business location, and 2) the time spent at each place. Additionally, the term "principal place of business" includes a place used by the taxpayer to conduct administrative or management activities of the taxpayer's business if there is no other fixed location of the business where the taxpayer conducts substantial administrative or management activities of the business.

In light of the extensive closing of office locations in connection with the COVID-19 restrictions and the resulting shift of business activities to home office spaces, many self-employed individuals may find they will qualify to claim a home office deduction. Self-employed individuals whose working locations have been impacted during 2021 should discuss the possibility of a home office deduction with their tax advisor. In particular, individuals whose business operates as a partnership or S-corporation will want to consult their tax advisors ahead of year-end as additional steps to preserve the deduction may need to be taken at the entity level before year-end.

Retirement

DISTRIBUTIONS

The Coronavirus Aid, Relief, and Economic Security (CARES) Act allowed certain individuals who were impacted by the coronavirus to take retirement plan distributions up to $100,000 during the 2020 calendar year without being subjected to the 10 percent early withdrawal penalty. Distributions made under these provisions are subject to tax over a three-year period as opposed to being taxed entirely in the year of receipt. Alternatively, the taxpayer could elect to recognize the distribution as taxable income entirely in the year of receipt or to treat the distribution as a non-taxable roll over to the extent they recontribute the distribution amount to an eligible retirement plan over the three-year period. Individuals who took a distribution under this provision and did not elect out of the three-year recognition provision will need to remember to factor in the 1/3rd income inclusion for 2021 when planning.

REQUIRED MINIMUM DISTRIBUTIONS (RMD)

The temporary waiver of the required minimum distribution (RMD) requirements for 2020 by the CARES Act was not extended into 2021. Accordingly, taxpayers will once again find themselves subject to these requirements for 2021. Under the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 the required beginning date of a taxpayer who had not attained the age of 70 ½ by December 31, 2019, will be determined with reference to the year the taxpayer attains age 72.

Individuals who have inherited an IRA will generally be subject to a minimum distribution requirement on the account regardless of age.

Taxpayers subject to these rules will want to work with their investment advisors and plan administrators, if applicable, to ensure distributions are timely made in order to meet these requirements and avoid the imposition of the 50% excise tax applicable to any shortfall.

ROTH CONVERSIONS

The primary benefit of a Roth individual retirement account (IRA) is that it allows earnings to accumulate and ultimately be distributed tax-free at retirement age. This effectively results in zero tax being paid on the earnings portion of the account. Also, Roth IRAs are not currently subject to RMD requirements during the account owner's lifetime, thereby allowing individuals to take money only as needed. Roth accounts might also be utilized as part of a strategy to maximize the after-tax value of an individual's legacy by minimizing the tax burden on their heirs. These attributes make Roth IRAs an attractive option for many taxpayers.

Amounts converted from a traditional retirement account to a Roth IRA are subject to tax in the year of conversion. Because funds used to satisfy the RMD requirement may not be converted to a Roth IRA, the RMD age account owner wishing to complete a Roth conversion must take both the RMD and conversion amount into taxable income in a single year.

Taxpayers who anticipate having business losses, which could be utilized to offset the additional taxable income from a Roth conversion, or who anticipate an increase in their future tax rate due to higher earnings or potential changes to the tax law, may find 2021 to be a particularly favorable year for a Roth conversion.

Under current law, conversion to a Roth IRA is irreversible as the former provision allowing for limited recharacterizations is no longer applicable. Therefore, taxpayers considering a Roth conversion will want to consult with their tax and financial advisors before implementation.

CONTRIBUTIONS

There are several actions to consider between now and year-end related to retirement plans and health benefits.

Due to the recent economic disruptions, many businesses may be anticipating losses for the 2021 tax year. When planning in loss years, remember that retirement plan contributions for business owners who operate as either a sole proprietor or or partnership will generally be limited, at least in part, by the self-employment earnings of the business.

At the same time, many plans require the business to make set contributions to employees' accounts, which are not based upon company net income. In some instances, continuing to make contributions at these levels in the future may prove to be a substantial burden on businesses that have incurred significant losses during the pandemic and are low on cash reserves.

Business owners in this situation may wish to consult with their tax advisor and third-party administrator prior to year-end regarding their plan requirements, any concerns they may have and available options for addressing their concerns moving forward.

Individuals seeking additional reductions to their taxable income for 2021 will want to consider maximizing contributions to their retirement and health plans for 2021.

Also, consider adjusting your 401(k) contributions for the rest of 2021 to contribute the most you can afford up to the maximum amount allowed based on your age and adjusted gross income (AGI). This may also allow you to take full advantage of any employer matching funds.

While IRA and self-employed retirement plan contributions can generally be made after the end of the year, start planning now to have the funds set aside to take advantage of these annual opportunities. Also, if you are considering starting a self-employed retirement plan, remember that while Simplified Employee Pension (SEP) plans may be set up as late as the due date of your return including extensions, other types of qualified plans such as Simple IRAs and solo-401(k)s must generally be set up by October 1st and the last day of the year for which you intend to make contributions, respectively.

Take action on your Flexible Spending Account for this year and next year. If you have a healthcare FSA, make sure to start using your remaining balance for 2021 by incurring reimbursable expenses before the plan's deadline. Also, you will need to determine your level of contribution for 2022 before December 31, 2021, if your plan has a calendar year-end.

Taxpayers with Archer Medical Savings Accounts (MSA) and Health Savings Accounts (HSAs) should consider making additional contributions for 2021 to contribute the most they can afford up to the maximum amount allowed, including any catch-up contributions allowable.

Wealth Preservation Planning

REVIEW OF DOCUMENTS AND PLANS

Periodically reviewing your wealth preservation and transfer plan documents with your legal, financial and tax advisory team is key to ensuring your long-term objectives are met in a tax-efficient manner. Viewing your plan as a "one and done" type of exercise fails to account for family, life, asset and tax changes, all of which could cause your static plan to yield unanticipated results. Additionally, a plan review tells you how you are currently positioned and allows you to be prepared for potential law changes.

Due to the myriad of tax, legal and other considerations, wealth preservation planning may be very complex. Additionally, any planning strategy must be properly executed, usually through detailed legal documents, in order to be effective. Individuals should consult with tax, legal and financial advisors who are well versed in this area when considering any type of wealth preservation strategy.

UTILIZATION OF INCREASED EXEMPTIONS

Under current law, taxpayers are provided with a sizable, unified exemption from federal estate and gift taxes, $11.7 million per person for 2021 and $23.4 million per married couple for 2021. However, under current law, these increased exemption amounts are set to expire after 2025, at which time they will revert to the prior lower levels which were in effect for 2017.

The current environment provides a unique opportunity for individuals to utilize the current high exemptions and available valuation discounts to move significant amounts of assets out of their estate as part of a strategic gifting plan.

INTENTIONALLY DEFECTIVE IRREVOCABLE TRUST (IDIT)

Individuals who are not yet ready to fully relinquish asset values may want to consider the use of an IDIT to ensure they are able to maximize application of the current exemption levels. Individuals using IDITs will generally sell the asset to the IDIT at current fair market value in exchange for an installment note with an appropriate fixed rate of interest. If executed properly, the transaction will be disregarded for income tax purposes but will be respected from an estate tax perspective. As a result, any future appreciation in the value of the asset will be outside of the individual's estate. Additionally, the individual has the option of making a gift of the note by forgiving the remaining balance due in the event they believe a reduction in the exemption amount is imminent.

GRANTOR RETAINED ANNUITY TRUSTS (GRATS)

In the current low-interest rate environment, GRATs may be a good option for individuals wishing to retain the right to an income stream while shifting future appreciation out of their estate. GRATs provide an annuity stream for a specified term of years equal to the value of the asset at the date of the contribution, plus a fixed rate of interest. The required rate of return is based upon the prevailing interest rate as published by the IRS. GRATs generally work well with assets producing a rate of return that will greatly exceed the rate of interest utilized for the annuity stream.

SPOUSAL LIFETIME ACCESS TRUST (SLAT)

Married individuals wishing to utilize the current high exemption levels before they expire may want to consider a SLAT, which is an irrevocable trust that includes the spouse as one of the allowable beneficiaries, generally in addition to children. By transferring assets to a SLAT, the individual shifts future appreciation outside of their estate and excludes the assets from their spouse's estate while still allowing for financial assistance to their spouse. In some instances, the use of a SLAT may also be viewed as providing some level of indirectly retained financial security. If the spouse is a discretionary beneficiary of both income and principal, the trustee may make distributions to the spouse if the couple's financial situation deteriorates.

In order to maximize each of their exemptions, spouses may wish to establish SLATs for each other. Careful planning in this situation can help to avoid application of the reciprocal trust doctrine.

Charity

PARTIAL ABOVE THE LINE DEDUCTION

Under the CARES Act as extended and modified by the Consolidated Appropriations (CAA) Act of 2021, individual taxpayers who do not itemize deductions are allowed to reduce their gross income by the amount of their qualified charitable contributions, not to exceed $300 ($600 for married filing joint taxpayers) per year. In order to be qualified, a contribution must be made in cash and generally must be made to an entity for which an itemized deduction would otherwise be allowable. Qualified contributions do not include any carryovers of charitable contributions under the itemized deduction rules or contributions to private foundations or for the establishment or maintenance of donor advised funds.

INCREASED DEDUCTION LIMITS

A taxpayer's charitable contribution deduction is limited to a percentage of their AGI, or in the case of C-corporations, a percentage of its taxable income. The events of 2020 and 2021 will likely result in many taxpayers having significantly reduced income. At the same time, many non-profit organizations are experiencing a significant increase in demand for their assistance.

In recognition of these opposing factors, the CARES Act modified the deduction limitation with respect to certain qualifying cash contributions in 2020. This modification was extended to 2021 as part of the CAA Act of 2021. The 2021 deduction limitation for qualified contributions made by non-corporate taxpayers during 2021 that itemize will be 100 percent of their AGI. Any excess qualified contributions will carryforward subject to the five-year carryforward period and 60 percent of AGI limitation.

The 2021 deduction limitation for qualified contributions of corporate taxpayers is 25 percent of taxable income with any excess contributions being carried forward subject to the regular limitations. Additionally, the percentage limitation for certain contributions of food inventory is increased from 15 percent to 25 percent in the case of contributions made in 2021.

Generally, a qualified contribution is any charitable contribution made to an entity for which an itemized deduction would otherwise be allowable, and which is paid in cash during calendar year 2021. However, qualified contributions do not include any contributions to private foundations or for the establishment or maintenance of donor advised funds. Additionally, in order for a contribution to be a qualifying contribution, the taxpayer must make an election to treat the contribution as a qualified contribution subject to these rules.

GIVING STRATEGIES

Overall successful planning for charitable contributions will take into account not only timing with respect to applicable deduction limitations or use of the standard deduction in alternate years, but will also consider the type of assets available for donations, the methods available for making donations and, in some instances, the structuring of the contribution.

Consider making contributions of appreciated capital gain property instead of using cash. By contributing appreciated capital gain property held for at least one year before gifting, you are allowed a deduction for the full value of the asset without having to recognize taxable gain on the appreciation. This works particularly well with appreciated publicly traded stocks and mutual fund shares in conjunction with the regular rebalancing of your investment accounts. If your investment advisor suggests "taking profits" in one asset class and investing in another asset class, strongly consider this move.

On the flip-side, if you want to fund charitable gifts with devalued property, sell it to harvest the tax loss and then contribute the cash proceeds to the charity in order to recognize the maximum tax benefit.

The deduction for assets used in a trade or business or which are otherwise ordinary income type property will generally be limited to the taxpayer's basis in the property, and additional restrictions on the type and use of property by the recipient may apply. However, a deduction greater than the tax basis amount may be available for certain contributions made by C-corporations of wholesome food inventory and scientific property used for research.

There are several methods taxpayers may utilize for giving in order to achieve both their tax and non-tax giving objectives. Contributions to donor-advised funds may yield an immediate deduction of the full amount of the contribution, while allowing the actual gifts to charity to be spread out over time, based on your recommendations.

Charitable remainder annuity trusts (CRATs), charitable remainder unitrusts (CRUTs) or pooled income funds (PIFs) may be utilized as a way to donate property and recognize a charitable contribution deduction for a portion of the value while retaining an income interest for a period of time.

Taxpayers aged 70 ½ or older may make tax-free IRA distributions to charities of up to an annual maximum of $100,000. The annual cap may be lower than $100,000 if the individual has made any deductible contributions to an IRA after reaching age 70 ½. While an itemized deduction may not be taken for the tax-free contribution, there is also no income recognized because of the IRA distribution. Utilizing this structure is generally preferable if a taxpayer has no other significant itemized deductions for the year or where deductions might otherwise be limited by AGI. This approach may also be beneficial where adjusted income thresholds, such as those used for determining the taxability of social security, may be favorably influenced.

Investments

INTEREST AND DIVIDENDS

An annual review of your investment portfolio with your financial and tax advisory team is critical to ensuring your portfolio contains a balance of taxable and tax-exempt investments to support your income and growth goals in a tax-efficient manner. The BBBA as passed by the House includes a surcharge provision on modified adjusted gross income in excess of $10 million ($5 million for married filing separate) or $200,000 in the case of estates and trusts. The surcharge as currently drafted would be applicable for tax years beginning after December 31, 2021. While the BBBA has been passed by the House whether its provisions will ultimately be enacted as law is currently uncertain. However, this year may be a particularly critical year for high-income individuals to review their portfolios and have renewed discussions around the right mix of investments for the future.

CAPITAL GAINS AND ASSET SALES

Taxpayers generally have much control over the timing of sales of investments and other assets, and proactive planning for these events can generate significant tax benefits.

Review your investment portfolio with your financial and tax advisory team for any securities that could be sold at a capital loss before year-end to offset any capital gains that may have been generated. Overall net capital losses of up to $3,000 per year ($1,500 if married filing separate (MFS)) can be used to offset ordinary income in a year, and any excess beyond that amount is carried forward to future years. In assessing utilization of possible losses, remember that losses on securities sold are disallowed to the extent substantially similar securities are purchased within 30 days before or after the sale. This is generally known as the wash sale rule.

Non-recognition under the wash sale rules only applies in the case of losses and not gains. Taxpayers with existing available capital losses may want to consider a sale of appreciated investments to create corresponding gain and effectively obtain a tax-free step up in basis. This strategy may be helpful as a basis boost as part of a comprehensive tax-efficient gifting plan or for individuals who anticipate future changes in the taxation of capital gains and are concerned that restrictions on the use of pre-change carryforward capital losses might be restricted. While the BBBA currently does not include an increase in ordinary income or capital gains tax rates, the proposed legislation currently remains subject to changes as it makes its way through the legislative process. Additionally, as described in the Interest and Dividends section the current draft of the BBBA does include a surcharge on the excess modified adjusted gross income of certain high-income individuals, estates and trusts. Taxpayers who believe they may be subject to an increased tax burden on future gains may wish to accelerate gains into the current year, even if they will not be offset by losses, in the hopes of realizing a permanent tax savings.

The current version of the BBBA also includes a provision that potentially expands applicability of the 3.8% net investment income tax for taxpayers with modified adjusted gross income in excess of a “high threshold” amount. The threshold amount would be $500,000 for married filing joint or surviving spouse ($250,000 if married filing separately) and $400,000 for others. This provision would also apply to estates and trusts with income subject to the highest tax rate. Under current tax law, active owners of S-corporations or partnerships are generally able to exclude income derived in the ordinary course of business as well as gains associated with the sale of the business or their ownership interest in the business from the net investment tax. However, if enacted into law the BBBA provision would potentially cause such income and gains to be subject to the net investment income tax for taxpayers with modified adjusted gross income in excess of the “high threshold”. Active shareholders and partners currently negotiating a sale of the business or of their ownership interest and who believe they may be subject to net investment, or other potential tax increases, in 2022 may want to factor this in when planning for the sale and the closing date.

Taxpayers with significant capital gains may want to consider reinvesting some or all of these gains in a Qualified Opportunity Zone Fund (QOZF). Reinvested gain is deferred until the earlier of the date the taxpayer disposes of the interest in the QOZF or Dec. 31, 2026. Taxpayers who hold their interest in the QOZF for at least five years prior to Dec. 31, 2026, may be able to permanently exclude 10 percent of the originally reinvested gain. Taxpayers who continue to hold their interest for 10 years or longer will also be able to permanently exclude gains attributable to appreciation of the new investment.

Taxpayers wishing to utilize this strategy will need to reinvest eligible gains in the QOZF within 180 days from the date of sale. Eligible capital gains which are passed through by a partnership or S-corporation may be reinvested within 180 days of the entity’s year-end (December 31 for calendar year entities), 180 days from the original due date of the pass-through entity’s tax return, or the partner may elect to use the partnership’s reinvestment period to invest earlier. In some cases, all or a portion of the gain from the sale of property used in a business or other for-profit activity may be eligible for reinvestment in a QOZF. Individuals pursuing these investments will want to work closely with their financial and tax advisory team to ensure correct identification of eligible gains and to understand the impact a particular QOZF investment might have on their overall portfolio and ability to meet long-term financial goals.

Consider a like-kind exchange when disposing of real property. Taxpayers who are looking to dispose of one piece of real estate and acquire another may be able to do so without triggering gain by structuring the transactions to qualify as a like-kind exchange. On the other hand, if the taxpayer anticipates realizing a loss on the property to be sold, the taxpayer will want to be sure the transactions are structured to avoid classification as a like-kind exchange, thereby allowing the taxpayer to recognize the loss on disposal.

Individuals or partnerships who sell or dispose of non-public C-corporation stock which was directly issued to them by the corporation should consult with their tax advisor regarding potential qualification as small business stock (Section 1202 stock) eligible for gain exclusion (in the case of a sale at a gain) or ordinary loss recognition in the case of sale or disposal at a loss (Section 1244 stock) based upon the specific facts and circumstances relating to the investment and disposition.

INVESTMENT INTEREST EXPENSE

Generally, interest on debt incurred to acquire or carry investment assets is deductible by individuals as an itemized deduction. The interest expense which will be allowed as a deduction for the year is limited to the taxpayer's net investment income. Net investment income does not include qualified dividend income or capital gains except to the extent a taxpayer affirmatively elects to treat all or a portion of this type of income as investment income for this purpose. Effectively, taxpayers making this election are trading the chance to use the interest expense to offset ordinary tax rate investment income in the future for a chance to offset income that would ordinarily be taxed at lower rates.

Interest on debt to acquire or carry investments in a pass-through entity, provided certain criteria are met, may be treated as trade or business interest instead of investment interest. In these instances, the interest expense deduction is not limited to investment income but may be subject to and limited by the business interest expense limitation. Additionally, interest in this category will result in a reduction of AGI as opposed to a "below-the-line" itemized deduction. Taxpayers who have borrowed money to fund flow-through businesses should consult with their tax advisor regarding application of interest tracing rules and whether they may be eligible for additional business deductions relating to the interest paid.

529 PLANS

A qualified tuition program, also known as a 529 plan, allows taxpayers to make nondeductible contributions to fund the higher education needs of a designated beneficiary. The earnings in the account accumulate tax-free and may be distributed tax-free to the extent the funds are utilized to pay the qualified higher education expense of the beneficiary.

The Setting Every Community Up for Retirement Enhancement (SECURE) Act recently expanded the ability to utilize 529 plan funds by allowing tax-free distributions to pay for fees, books, supplies and equipment required for the designated beneficiary's participation in a certified apprenticeship program. Additionally, the SECURE Act made changes to allow tax-free distributions for payments of principal and interest on qualified education loans of the beneficiary or a sibling of the beneficiary. Tax-free distributions used for student loan payments are limited to an aggregate of $10,000 per individual over their lifetime.

Business

REVENUE RECOGNITION AND TIMING OF DEDUCTIONS

There are many options available to businesses to affect the timing of when revenue and deductions are factored into taxable income. Generally, taxpayers will prefer to adopt allowable accounting methods that will defer revenue and accelerate deductions. However, as described in earlier sections the BBBA as passed by House contains a surcharge provision on taxpayers with modified AGI in excess of $10 million and potentially expands the types of income subject to the net investment tax for taxpayers with modified AGI in excess of the "high threshold". Currently, the BBBA has not been passed by the Senate, leaving uncertainty as to what ultimate legislation, if enacted, will look like. Taxpayers who believe they may be subject to increased tax burdens for 2022 and future years, may want to consider timing strategies that would accelerate revenue into 2021 and defer deductions into future years in the hopes of realizing a permanent tax savings.

Overall method of accounting: The broadest item to consider is the overall method of accounting – generally the cash or accrual methods. Consider whether your business is eligible for the expanded use of the cash method. The cash method is generally available to small businesses with average annual gross receipts of less than $26 million. The cash method is generally considered more tax-efficient than the accrual method when accounts receivable exceeds accounts payable and certain accrued expenses.

Accrual method taxpayers have many options available to affect the timing of deductions. Businesses should review their accrued expenses to identify the most advantageous method of accounting for these items.

Common items where opportunities exist to accelerate deductions include accrued compensation (including, bonuses, vacation, sick pay, severance, etc.), accrued services, accrued taxes, self-insured accrued employee medical expenses, accrued insurance, prepaid insurance and prepaid real property taxes among others.

INVENTORY AND UNICAP

Inventory: Opportunities may exist to capture additional deductions through your inventory valuation accounting methods, such as Subnormal Goods and Lower of Cost or Market (LCM). "Subnormal goods" are generally inventory that cannot be sold in the normal way because of damage, imperfections, odd or broken lots, style changes or other similar causes. Meeting certain criteria, these items may be eligible for an inventory write-down, accelerating a tax deduction to 2021 that might otherwise not be realized until a later year. Have you experienced falling prices in the market value of inventory? Businesses on an LCM inventory method may have an opportunity to write down the carrying cost of the inventory to a lower cost or market value. The key is to identify inventory items with a market value less than the current carrying cost. Establishing the market value, however, is not arbitrary and requires establishing a value based on evidentiary market cost data.

Businesses that meet the fact patterns to claim an inventory write-down may be required to change their accounting method before claiming the deduction. Consult your tax adviser to discuss the process and your eligibility for changing your accounting methods to accelerate deductions for your inventories on hand.

UNICAP: Businesses are often required to capitalize additional costs into ending inventory on top of what is capitalized for financial accounting purposes. This is referred to as Uniform Capitalization – UNICAP for short – or 263A costs. Final IRS regulations, which were generally effective starting in 2019, introduced a broad range of modifications to how inventory costs are computed under UNICAP.

These regulations introduced a new allowable method of computing Section 263A costs on-hand: the modified simplified production method (MSPM). The MSPM allows manufacturers and manufacturer-resellers to derive tax benefits from a more favorable treatment of their raw materials and any resale inventories.

In addition to generating tax benefits, taxpayers may find that the MSPM offers a reduced administrative burden. By adopting the MSPM, taxpayers may avoid the regulations' more stringent restrictions on taxpayers using the Simplified Production Method – including the requirement to compute book inventory costs on a tax basis and a restriction on using negative adjustments to remove costs not required to be capitalized.

Taxpayers may generally adopt the MSPM for tax years 2019 and forward. Businesses that have not determined the applicability or implemented these final regulations should consult with their tax advisor to determine if tax savings opportunities exist.

FIXED ASSETS AND DEPRECIATION

Businesses are permitted generous opportunities to immediately deduct the cost of investments in certain fixed assets. These deductions are claimed through "bonus depreciation" and Section 179.

Bonus Depreciation: Certain business assets eligible for immediate deduction generally include machinery, equipment, furniture and fixtures, land improvements, software, Qualified Improvement Property and other non-building assets. Eligible assets are not required to be new purchases – as in the past – but now must only be "new to you." There is no limit on the amount of bonus depreciation deduction that may be claimed to reduce taxable income.

Qualified improvement property (QIP): QIP generally encompasses interior improvements made by the taxpayer to a building that does not include an enlargement, expansion or altering the building's internal structural framework. Prior to 2020 and due to a drafting error in the TCJA, QIP was depreciated over 39 years and was not eligible for bonus depreciation. The CARES Act passed in early 2020 corrected this error, changing the depreciation period for QIP to 15 years, as well as making the assets eligible for bonus depreciation. The correction of this error was made retroactively to the beginning of 2018. Taxpayers may be able to catch up on missed deductions under the prior law by filing an accounting method change if they have not already filed amended returns or made the method change in the 2020 tax year.

If you are contemplating a purchase of business assets, consider doing so and placing them in service before December 31, 2021, to claim bonus depreciation. If you acquired, renovated or substantially improved a building, consider implementing a cost segregation analysis to maximize the cost eligible for QIP and bonus depreciation. A cost segregation analysis can be implemented retroactively through an accounting method change – without amending tax returns – to capture depreciation deductions missed on prior tax returns.

Section 179: This is another asset-expensing provision. It applies to similar types of property as bonus depreciation, generally non-building assets. The maximum deduction under this provision for 2021 is $1,050,000 and begins to phase out once a taxpayer's annual investment in eligible assets exceeds $2,620,000. The TCJA also expanded the definition of eligible Section 179 property to include the following improvements installed in a building after initial construction (i.e., not new construction): qualified improvement property (same definition as above under bonus depreciation), and certain improvements to non-residential property, including roofs, HVAC property, fire protection and alarm systems and security systems.

Taxpayers seeking to defer deductions for 2021 may want to consider electing out of bonus depreciation, forgoing the available 179 deduction or possibly even delay acquiring and placing fixed assets into service until 2022.

BUSINESS INTEREST EXPENSE

Under current law, interest expense generally may not exceed 30 percent of taxable business income before depreciation, amortization, depletion, and interest expense (also known as adjusted taxable income or ATI). In tax years beginning after 2022, this limitation becomes even more restrictive as the limitation will no longer be applied before the deduction for depreciation, amortization, and depletion.

In late 2020 and early 2021, the IRS provided additional guidance on the business interest expense limitation in the form of final regulations. The final regulations issued in late 2020 are generally applicable for tax years beginning after November 13, 2020, however taxpayers may choose to apply them to taxable years beginning after December 31, 2017, so long as the taxpayers and their related parties consistently apply them. The final regulations contained many revisions from the previously proposed regulations which might be considered taxpayer-friendly, including revisions to the types of expenditures considered to be interest subject to the limitation, changes in the computation of ATI for taxpayers subject to UNICAP and application of a singular qualification for the small business exemption at the entity level. Beyond this, potentially favorable changes were made with respect to multi-national businesses. Taxpayers whose business interest expense deductions for 2018, 2019, or 2020 were limited may want to evaluate their original filing positions against the guidance of the final regulations to identify whether there may be a potential benefit to file amended returns to take positions aligned with the final regulations.

Additionally, taxpayers may want to evaluate the potential impact of the final regulations as they apply the business interest expense limitation for 2021 and future years.

Under the final regulations taxpayers owning multiple pass-through entities with intercompany loans or who have made loans to their majority-owned S-corporations may find their tax liability significantly impacted by the business interest expense limitations. For example, if an S-corporation shareholder loaned money to the S-corporation itself, additional tax may arise due to the potential mismatching of the income (investment interest income recognized by the shareholder) compared to the expense (limited business interest expense recognized by the S-corporation). A similar issue existed with respect to related party loans and the passive loss limitations under Section 469. However, the IRS issued regulations to favorably address and resolve the Section 469 mismatch issue. In late 2019, the IRS indicated it was considering issuance of similar regulations to favorably resolve the mismatch issue with respect to the business interest expense limitation. However, the newly effective and final regulations provide relief solely with respect to loans made between a partner and partnership. Taxpayers with significant loans to their majority-owned S-corporations or between related businesses should consider discussing the potential tax implications and restructuring options for minimizing tax distortions with their tax advisor.

Other issues addressed by the final regulations include interest tracing, particularly relating to debt-financed distribution interest, treatment of interest on loans to acquire ownership in flow-through entities and application of the business interest expense limitations in the case of tiered partnerships.

The BBBA as passed by the House includes changes that would apply the business interest expense limitation at the partner or S-corporation shareholder level instead of the entity level. This change if enacted as drafted would create new issues for which guidance would need to be provided and may render some provisions of the existing final regulations inapplicable.

CONVERSIONS TO QUALIFIED SMALL BUSINESS STOCK

Holders of C-corporation stock which is qualified small business stock (QSBS – Section 1202 stock) may be able to exclude all or part of the gains from the sale or exchange of the stock if they have held the stock for more than five years.

Due to recent economic disruptions, private equity and other small business equity investors may now be looking at holding on to their ownership in various operating companies longer than originally intended. In some instances, it may make sense for controlling equity investors to consider restructuring an entity as a corporation in order to qualify the investment for treatment as qualified small business stock at a future date.

Equity investors considering this strategy will want to consider their anticipated exit date as well as the tax trade-offs associated with operating as a C-corporation going forward.

Navigating the rules governing qualified small business stock and the associated gain exclusions can be complicated. Investors interested in exploring conversion should work with their tax advisor to better understand the requirements and assess the potential in their specific situation.

Under the BBBA as passed by the House, taxpayers with an adjusted gross income of $400,000 or more the maximum gain exclusion percentage would be 50% even if the sale otherwise meets the 75% or 100% requirements. If enacted as drafted, this change would generally apply to sales or exchanges after September 13, 2021.

STATE AND LOCAL TAX

Most businesses have experienced a shift to a remote work from home environment fora significant portion of their workforce during 2020 and on into 2021. In some instances, employees working from home may now live in state and local jurisdictions where the business would not normally have a physical presence. Additionally, businesses may have seen shifts in their customer base as they have shifted to more of a virtual sales and delivery model. Physical presence in a jurisdiction can be sufficient to create a filing obligation. Furthermore, in many jurisdictions, simply exceeding a threshold of sales into the jurisdiction can create a filing obligation. Businesses impacted by these types of changes should work closely with their tax advisor to ensure they are in compliance with the various state and local jurisdictions for purposes of income tax, franchise tax, gross receipts and other taxes.

When filing state and local returns this year, businesses will also want to consult with their tax advisor to determine if there are any special apportionment elections available that might reduce their overall state tax burden. Businesses that have revenue from services and intangibles will also want to consider the proper revenue sourcing rules in each state. Since the laws vary state to state, possible scenarios can exist that the same revenue is attributable to multiple states or certain items of revenue might not be attributable to any state.

Related business groups, including groups filing consolidated federal returns, should also consider whether they are utilizing the appropriate statutory filing methodologies (combined, consolidated, separate, etc.) as well as whether there are any elective filing methodologies available that might yield tax savings.

STATE AND LOCAL TAX CREDITS AND INCENTIVES

As businesses continue to adapt and make changes to how they operate, it is important to continually consider what activities they may have in a jurisdiction that might create the opportunity for statutory or negotiated credits or incentives. Increased headcount, capital expenditures, research and development, training expenses, etc., are all items that have the potential to generate state and local tax credits. Some of these credits can offset tax types other than income tax (i.e., withholding).

SALES AND USE TAX

Sales and use tax liabilities may also be impacted by the recent shifts to remote work and customer base. A physical presence or a threshold level of sales can create a filing obligation in virtually every jurisdiction. As a result, businesses should consider whether they are properly registered for sales and use tax in each jurisdiction and are collecting and remitting to the appropriate jurisdictions.

Most states' economic nexus threshold is either \$100,000 or \$250,000. For more information, DHG has a complete list of economic nexus thresholds.

The sales and use tax area is an evolving landscape with many jurisdictions now subjecting digital products, SAAS, services, etc., to tax. In addition to registering and filing in the appropriate jurisdictions, businesses also need to consider the taxability of products and services sold. Businesses should also consider whether they are taking full advantage of all exemptions available to them on items purchased for use in their business. Identifying the available exemptions in each jurisdiction can reduce tax burdens going forward and generate potential refunds from prior years.

PLANNING FOR LOSSES

NOL CARRYFORWARDS (SECTION 382 LIMITATIONS)

Some taxpayers may have significant unutilized NOLs carrying forward into 2021 or beyond.

At the same time, many companies are looking to raise additional capital, restructure their debt-to-equity stack, reorganize entirely, or are experiencing incremental ownership changes for other reasons. Corporations experiencing such ownership changes will need to be vigilant in monitoring the cumulative impact of these changes occurring within any rolling three-year period. Otherwise, these companies run the risk of inadvertently triggering Section 382 limitations on the use of NOL carryforwards.

While most people generally associate Section 382 limitations with the use of NOL carryforwards of C-corporations, the limitations may apply to other tax attributes as well (including the excess business interest expense carryforwards of both C- and S-corporations).

Measurement and determination of ownership changes for purposes of Section 382 can be complex and cumbersome for several reasons, including the need to measure change based on stock value, the difficulty of measuring incremental ownership changes over the rolling period, the possibility of multiple Section 382 ownership changes occurring within a single tax year and the potential treatment of certain non-stock instruments as stock for purposes of measuring the change. In particular, small public companies may be at risk of unknowingly triggering limitations. Taxpayers not well versed in these rules and are experiencing or anticipating ownership changes should proactively consult with their tax advisor to evaluate and plan around potential limitations.

LOSS LIMITATIONS ON PASS-THROUGH BUSINESSES – BASIS, AT-RISK AND PASSIVE

Taxpayers anticipating losses from one or more of their pass-through business interests (S-corporations, partnerships, sole-proprietorships) may find themselves unable to fully utilize these losses due to various limitations. Knowing the impact these limitations may have is key to a taxpayer's overall tax planning. Additionally, by planning proactively, taxpayers may be able to take steps to minimize the impact of limitations.

Basis and at risk for taking losses. Taxpayers may only deduct losses from flow-through entities to the extent that they have both basis and at-risk amounts sufficient to absorb the loss. Accurately compiling and knowing your basis amount is key to being able to evaluate and proactively plan for utilization of significant losses.

Additionally, identifying taxpayers who are deducting losses in excess of their basis and at-risk amounts has been a key focus of the IRS in recent years. The IRS recently initiated a requirement to report partners' tax capital and certain at-risk information with the partnership return. Similarly, individual taxpayers are now required to report S-corporation basis information on their individual income tax returns if a loss is passed through to them or if they received distributions from the S corporation.

If you are anticipating losses from partnerships or S-corporations with low basis and at-risk, consider taking steps such as contributing capital or making a direct loan to the entity to bring basis and at-risk amounts up to the amount of loss. The basis and at-risk rules can be quite complex, particularly with respect to partnership interests. Taxpayers who are unsure of their basis or at-risk amounts should work with their tax advisor to determine these amounts and to ensure any proposed steps you might take to increase these amounts will have the intended effect.

Passive activity loss planning. Taxpayers owning rental properties or business interests for which they do not meet the material participation requirements may be further limited on the amount of losses they are able to utilize from those activities within a given year. Generally, passive losses may only be utilized to the extent of passive income and may not offset other non-passive income. An exception is allowed in the case of passive activities with losses, including carryover losses from prior years, that are fully disposed of during the current year.

Taxpayers with passive activity loss carryovers or passive activities for which they anticipate a current year loss should review their various activities to identify any "loss leaders" that should be disposed or discontinued and consider the potential for accelerating that event into the current year in order to free up losses.

Another planning strategy to consider is altering the level of involvement and amount of time spent on various entities. Whether a taxpayer is non-passive with respect to an activity is determined by meeting one of the tests provided in the Section 469 regulations. In the case of rental real estate activities, taxpayers will need to meet the real estate professional test in order to fully avoid classification as passive. The various tests are based on hours spent by the taxpayer on non-investor-type activities and are both specific and mechanical in operation. Taxpayers who meet the test in one year may not meet the test with respect to the same activity in other years. The rules also allow taxpayers to group certain activities for purposes of determining non-passive or passive status. This requires an affirmative election statement, and once made, can generally not be altered in future tax years.

To plan in this area, taxpayers should understand the rules that apply to their specific activities and work with their tax advisor to evaluate which activities will be treated as passive and which will be treated as non-passive.

Debt Modifications and Bankruptcy

Significant modifications of debt may result in a deemed settlement and exchange of the debt for tax purposes. Whether a modification is considered significant for tax purposes is governed by specific regulatory guidelines. Under the regulations, a significant modification may occur due to something as simple as the deferral of a payment beyond a certain period.

The CARES Act and other governmental actions have provided payment forbearance relating to the COVID-19 pandemic. Additionally, in light of the economic downturn and low-interest rates, many companies may be looking to renegotiate or refinance their debt. Whether refinanced with the existing creditor or with a new creditor, an analysis is required to determine if the debt modification constitutes a taxable event. To the extent that the fair market value of the original note exceeds that of the new note, a borrower may have cancellation of debt income. Additionally, debt issuance costs associated with the original debt may need to be examined for deduction or continuance. Tax rules are very different than the U.S. GAAP rules with regards to debt modifications and debt issuance costs, so care should be taken when considering a debt modification.

In some cases, companies in severe economic distress may be facing debt restructuring – whereby debt needs to be voluntarily or involuntarily forgiven in order for the company to survive. Such restructurings include intense negotiations and analyses by the debtor, its creditors and its shareholders and can be accomplished either under the legal oversight of formal bankruptcy proceedings or out of court. Either way, a company's tax profile and attributes are critical components of those negotiations. There are many courses that a debt restructuring may take – and each with a different tax implication. Companies considering debt restructuring should consult with their tax advisor as soon as possible regarding the potential tax implications.

Airplanes

There has been a marked increase in the use of private aircraft since the onset of the COVID-19 pandemic. Use of private aircraft by company personnel for business and non-business transportation is a specialized field with complex overlapping rules. Further increasing this complexity is the fact that each agency involved is solely focused on their area of responsibility when issuing and enforcing rules. For example, the IRS is concerned with tax collection while the Federal Aviation Administration's (FAA) concern is public safety. Each agency issues rules intended to address only their area of responsibility. As a result, in many cases, the rules for each agency do not mesh well together, and in some instances, may be in direct conflict with one another.

A company or its related entities do not have to own an aircraft to be subject to some or all these rules. Any use of private aircraft, including charter aircraft operated by third parties, and the associated expenses may subject a taxpayer to these rules. Additionally, planning for aircraft-related tax matters extends beyond income tax concerns. Consideration should also be given to the impact of federal excise taxes, state and local sales and use taxes, and various property tax assessments.

Proper structuring in this environment is paramount to achieving maximum legal protections and tax efficiencies regarding the use of corporate aircraft for business and non-business transportation. Structuring, when done correctly, requires a team effort by taxpayers, aviation legal counsel and accounting advisors specializing in aviation matters.

DHG has tax professionals well versed in the aviation space and has developed strong working relationships with multiple sources for aviation legal assistance.

International

FDII DEDUCTION

The deduction for foreign-derived intangible income (FDII) was first introduced in the TCJA enacted December 22, 2017, and is applicable to U.S. domestic C-corporations that directly (and in certain cases, indirectly from related foreign subsidiaries) derive income from sales or leases of property, performance of services, and licensing of property to foreign unrelated parties.

Under Section 250, corporate taxpayers may be eligible to deduct up to 37.5 percent of FDII. To implement this new tax deduction, Treasury released proposed regulations in 2019, which generally contained extensive documentation requirements for substantiating the foreign use of goods and services and other guidance impacting the calculation mechanics of the deduction.

The final regulations under Section 250 were published on July 15, 2020 (Final Regulations), adopting for the most part the provisions of the proposed regulations, but containing several important key modifications that affect the FDII deduction. The final regulations (1) relax the substantiation documentation requirements; (2) provide explicit presumptions applicable for certain factual situations; (3) allow for any "reasonable method" when coordinating the section 250(a)(2) taxable income limitation with other IRC sections (i.e., Section 172, Section 163(j)); (4) note that Sections 163(j), 170(b)(2), 172, 246(b) and Section 250 do not apply when allocating and apportioning deductions to gross deduction eligible income or gross foreign-derived deduction eligible income (FDDEI); and (5) clarify that FDDEI includes sales of digital content, as well as sales or services by the U.S. government under the Arms Export Control Act.

The final regulations generally apply to tax years beginning on or after January 1, 2021; however, taxpayers may opt to apply the final regulations to pre-2021 tax years, provided they apply such regulations in their entirety, with the exception of certain documentation requirements. Making the election to apply the final regulations to pre-2021 tax years relieves taxpayers of the extensive documentation requirements for substantiating a FDII transaction. As an alternative, taxpayers may rely on the proposed regulations also in their entirety for pre-2021 tax years, by following the documentation transition rule.

To take full advantage of the deduction for FDII, taxpayers should take steps before year-end to identify eligible transactions, collect the appropriate documentation supporting foreign use, consider expenses apportionment methods and review transfer pricing policies when foreign sales are between related entities.

GILTI HIGH-TAX EXCLUSION AND SECTION 163(J) CFC GROUP ELECTION

The Section 951A Global Low-Taxed Intangible Income (GILTI) regime was part of the TCJA and became effective for tax years beginning after Dec. 31, 2017. Under the GILTI regime, U.S. shareholders owning controlled foreign corporations (CFCs) are generally subject to an annual inclusion to U.S. taxable income on their net CFC tested income earned subject to certain adjustments made for tested losses and ownership of assets deemed to be qualified business asset investments. The inclusion amount is calculated based on an aggregate of the shareholders' pro rata share of tested income and tested loss from each CFC owned. The tax on the GILTI inclusion is intended to impose a minimum tax on U.S. shareholders of CFCs to generally result in a tax rate of no less than 10.5 percent after the application of the Section 250 deduction.

The Final Regulations issued July 20, 2020, finalized the new high-tax exclusion with respect to tested income subject to tax under Section 951A (the GILTI High-Tax Exclusion). Under the GILTI High-Tax Exclusion provision, U.S. taxpayers can elect to exclude income subject to an overall effective tax rate of 18.9 percent or more in the foreign jurisdiction.

The GILTI High-Tax Exclusion is an elective provision that is made annually by all CFCs of a controlling domestic shareholder's group (CFC Group) and is based on the high-taxed tested income items of "tested units." A "tested unit" is generally defined to refer to different types of foreign entities: a CFC; interest in a pass-through entity (e.g., partnerships and disregarded entities) held, directly or indirectly, by a CFC; or a branch, or a portion of a branch, where the activities are carried on directly or indirectly by a CFC. The "tested unit" standard requires taxpayers to look through the CFC structure to compute the GILTI High-Tax Exclusion at each tested unit level.

The final regulations generally apply to tax years of foreign corporations beginning on or after July 23, 2020, and to taxable years of U.S. shareholders in which or with which such taxable years of the foreign corporation's end.

The regulations allow taxpayers to amend their U.S. tax returns for tax years in which GILTI was applicable (i.e., tax years beginning after Dec. 31, 2017) so that they can make the GILTI High-Tax Exclusion election provided they comply with certain filing requirements and consistency rules prescribed under the final regulations. Accordingly, taxpayers who have already filed U.S. tax returns with a GILTI inclusion may wish to revisit their prior years GILTI inclusion and foreign tax credit computations to determine whether filing an amended return with or without a GILTI High-Tax Exclusion election, taking into consideration the "all or nothing" provision included in the final regulations and the conformity with Section 954(b)(4)'s high-tax exclusion for subpart F income, as well as the application of the modified section 163(j) CFC Group election, leads to a more favorable result.

FOREIGN TAX CREDIT REGIME

The U.S. foreign tax credit (FTC) regime is designed to avoid double taxation of U.S. taxpayers' foreign source income taxed by both the U.S. and a foreign country. The TCJA introduced new provisions under Section 951A (GILTI inclusion) and Section 250 (FDII deduction), which in turn had a significant impact on the foreign tax credit regime and related rules for allocation and apportioning deductions in determining the foreign tax credit limitation. Proposed regulations were issued in 2018 related to FTC and finalized in December 2019, when new proposed regulations were issued, specifically related to changes made by the TCJA and other FTC issues.

The final FTC regulations were released September 29, 2020, providing further guidance on the allocation and apportionment of deductions under Sections 861 through 865, including rules for allocation and apportionment of research and experimentation expenses, creditable foreign taxes, definition of financial services income, foreign tax redeterminations, treatment of certain payments under the GILTI provisions, the availability of foreign tax credits under the transition tax, etc. In addition, new proposed regulations were also issued on the same day providing some initial preliminary guidance on the disallowance of a credit or deduction for foreign income taxes with respect to Section 245A dividends received deduction, the allocation and apportionment of interest expense, foreign income tax expense and certain deductions related to life insurance companies, the time at which foreign taxes accrue and can be claimed as a credit, etc. The foreign tax credit rules continue to be complex and intertwined with other IRC sections. U.S. multinational taxpayers who claim credits or deductions for foreign income taxes, or that claim a deduction for foreign-derived intangible income (FDII) should determine the impact of the various regulation packages on their ability to claim credits or deductions to avoid any unintended consequences, and also consider strategies for improving the FTC benefit.

Other Relief Provisions

EMPLOYER FICA DEFERRAL

The CARES Act provided many beneficial relief measures for taxpayers to conserve cash during the pandemic. One of those relief measures allowed employers to defer payment of the employer's portion of Social Security taxes during the deferral period beginning on March 27, 2020, and ending on December 31, 2020. Under the CARES Act, underpayment and failure to deposit penalties are not incurred so long as 50% of the deferred payroll taxes are paid in by December 31, 2021, and the remaining 50% is paid in by December 31, 2022.

It is important for taxpayers who took advantage of this payroll deferral provision to incorporate cash flow planning as they approach year-end in order to ensure they are able to meet the initial 50% repayment requirement. In IRS Program Manager Technical Advice Memorandum 2021-07 the IRS clarified that under the statutory language of the CARES Act provision avoidance of the penalties is dependent upon the taxpayer timely and fully meeting both payment installment requirements and that failure to do so will result in application of penalties on all of the deferred taxes based upon their original due dates. Accordingly, taxpayers will want to exercise great care to ensure they do not miss the mark on these payment obligations in 2021 or 2022. For additional information on this topic read our Alert here.

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