2022 Year-End Tax Seminar

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Agenda

1. Energy credits
2. Individual tax rates & brackets
3. Strategies for year-end tax planning
4. Virtual currency
5. Disaster losses

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Electric Vehicle Credit – 2023

Credit
- Used Vehicles – up to $4,000
- New Vehicles – up to $7,500

Assembly
- Final in North America
- Check VIN

Manufacturer Limitation
- 200,000-manufacturer vehicle cap limitation eliminated

AGI Limitation
- MFJ $300,000
- Single $150,000

MSRP Limitation
- $80,000 for vans, pickup trucks, and sport utility vehicles;
- $55,000 for other vehicles

Reporting the Credit
- 2023 – Tax Return
- 2024 – Point of Sale

Energy-Efficient Home Improvement Credit

Pre-IRA

- 10% tax credit for qualified energy efficiency improvements and expenditures for residential energy property on taxpayer's primary residence
- Taxpayers could also claim the credit for 100% of the costs associated with installing certain energy-efficient water heaters, heat pumps, central air conditioning systems, furnaces, hot water boilers, and air circulating fans
- Lifetime credit limit of $500 and $200 lifetime limit for new windows; $50 credit limits for air circulating fans; $150 some furnaces and boilers; and $300 certain water heaters, heat pumps, and air conditioning systems

Post-IRA

- Credit rate increased to 30% of cost of eligible improvements
- $250 limit for <u>one</u> exterior door, $500 limit for <u>all</u> exterior doors
- $600 limit for exterior windows and skylights; central air; electric panels; natural gas, propane or oil furnaces, or hot water boilers

2022 Federal Income Tax Rates

- Minimize taxes
- No rate increase proposals
- Inflation impact

2022 Tax Rate	Joint/Surviving Spouse	Single	Head of Household	Married Filing Separately
10%	$0 – $20,550	$0 – $10,275	$0 – $14,650	$0 – $10,275
12%	$20,551 – $83,550	$10,276 – $41,775	$14,651 – $55,900	$10,276 – $41,775
22%	$83,551 – $178,150	$41,776 – $89,075	$55,901 – $89,050	$41,776 – $89,075
24%	$178,151 – $340,100	$89,076 – $170,050	$89,051 – $170,050	$89,076 – $170,050
32%	$340,101 – $431,900	$170,051 – $215,950	$170,051 – $215,950	$170,051 – $215,950
35%	$431,901 – $647,850	$215,951 – $539,900	$215,951 – $539,900	$215,951 – $323,925
37%	Over $647,850	Over $539,900	Over $539,900	Over $323,925

Delaying and Reducing Gains

- Offset capital gains with capital losses
- Installment sale for gain deferral
- Wash sale rules
- Net investment income surtax

2022 Long-Term Capital Gains Tax Rate	Joint/Surviving Spouse	Single	Head of Household	Married Filing Separately
0%	$0 – $83,350	$0 – $41,675	$0 – $55,800	$0 – $41,675
15%	$83,351 – $517,200	$41,676 – $459,750	$55,801 – $488,500	$41,676 – $258,600
20%	Over $517,200	Over $459,750	Over $488,500	Over $258,600

Maximize Deductions – Bunching Strategy

- Standard or itemized

Charitable Contributions	Medical Expenses	Mortgage Interest	State & Local

• 60% AGI limitation
• No longer $300/$600 above the line deduction
• Appreciated stock
• Donor Advised Fund
	• 7.5% AGI limitation
	• Eligible expenses
	• Doctors, mental health services, health insurance, Medicare premiums
	  • Long-term care
	  • Home improvements to accommodate a disability
		• Pay Jan. 2023 mortgage before year end	• $10,000 limitation

***Planning Observation – Donations directly from a traditional IRA will not go toward charitable total but also not taxable**

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Excess Business Losses Under Section 461(l)

- Created under the TCJA for years 2018 – 2025
- CARES Act – delayed implementation until 2021
- Inflation Reduction Act - extended through 2028
- An excess business loss is the amount by which the total deductions attributable to all your trades or businesses exceed your total gross income and gains attributable to those trades or businesses (adjusted for cost of living)
- For taxable years beginning in 2022, the threshold amounts are $270,000 ($540,000 MFJ)
- Any excess losses are treated as NOL carryover to the following year

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Net Operating Losses (NOLs)

- TCJA modified the treatment of NOLs
- Deduction is limited to 80% of taxable income
- Carryforward indefinitely
- Carrybacks no longer allowed
- CARES Act
    - Allowed 5 year carryback in 2018, 2019, 2020

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Virtual Currency

- Started with Bitcoin in 2009
- There are estimated over 20,000 cryptocurrencies currently in circulation
- Common uses:
  - Investment trading
  - Business transactions
  - Technology applications
  - Mining
- Tax applications and relevance?
  - Several IRS Notices issued on the topic along with FAQs
  - Increased broker reporting starting in 2023 (Infrastructure Investment and Jobs Act)
  - Increased enforcement focus

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Virtual Currency, *(continued)*

- Sales – capital gain or loss
  - Basis methodology – specific identification (FAQ #39)
  - Harvesting/planning for year-end
- Rewards – ordinary income
- Conversions
- Forks – “protocol changes” to the ledger
  - Soft fork – typically no tax implications
  - Hard fork – may result in taxpayer receiving new units of the virtual currency or a new virtual currency

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Casualty & Disaster Losses

Federal Casualty Loss	Disaster Loss	Qualified Disaster Loss
• Loss attributable to federally declared disaster • Disaster occurs in state receiving federal disaster declaration • Personal-use property casualty or theft • $100 reduction and 10% of AGI adjustment	• Loss incurred in area determined to warrant federal assistance (FEMA declaration) • Eligibility to business / income producing property • Deduct loss in year of loss or preceding tax year • $500 reduction, NO 10% of AGI adjustment	• Personal-use property loss from major disaster declaration • Subject to certain time periods (subject to revision) • Eligible to deduct loss without itemizing deductions • $500 reduction, NO 10% of AGI adjustment

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2022 Tax Planning Strategies – Retirement and Health Savings Plans

401(k) Plans

- $20,500/year
- $27,000/year for age 50 or older with catch-up
- Maximum eligible compensation base is $305,000

IRA Contributions

- Deductible contributions up to $6,000 ($7,000 for age > 50)
- AGI max phase-outs for deductible contributions
  - Single: $78,000
  - MFJ: $129,000 if covered by workplace plan
  - MFJ: $214,000 if spouse covered by workplace plan

ROTH IRA Contributions

- $6,000 contribution ($7,000 for age > 50)
- AGI max phase-outs for contributions
  - Single: $140,000
  - MFJ: $208,000
- Back-door ROTH still viable for non-deductible contributions

FSA and HSA Contributions

- FSA Max Deferral: $2,850
- FSA Rollover to 2023: maximum of $570
- HSA Max Deferral
  - Single: $3,650
  - Family: $7,300
- HSA Catch-up contributions $1,000
- No limitation on HSA Rollover to 2023

2023 Federal Income Brackets

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

***Planning Observation – at the highest rate nearly $45,000 of individual income is eligible to be taxed in 2023 at the 35% rate**

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2023 Federal Long Term Capital Gains Brackets

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

Planning Observation – Capital Gains are still subject to the 3.8% Net Investment Income Tax

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2023 Retirement and Medical Savings Plans

401(k) Plans

- $22,500/year
- $30,000/year for age 50 or older with catch-up
- Maximum eligible compensation base is $330,000

IRA Contributions

- Deductible contributions up to $6,500 ($7,500 for age > 50)
- AGI max phase-outs for deductible contributions
  - Single: $83,000
  - MFJ: $136,000 if covered by workplace plan
  - MFJ: $228,000 if spouse covered by workplace plan

ROTH IRA Contributions

- $6,500 contribution ($7,500 for age > 50)
- AGI max phase-outs for contributions
  - Single: $153,000
  - MFJ: $228,000
- Back-door ROTH still viable for non-deductible contributions

FSA and HSA Contributions

- FSA Max Deferral: $3,050
- FSA Rollover to 2024: maximum of $610
- HSA Max Deferral
  - Single: $3,850
  - Family: $7,750
  - HSA Catch-up contributions $1,000

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Looking Forward

- Social Security cost of living increase 8.7% in 2023 – consideration to tax bracket planning
- Planning for 2022 and 2023 currently set to follow normal planning approach:
  - Defer income and accelerate deductions
  - Manage income tax brackets
  - Maximize retirement contributions where possible
  - Consider state tax planning opportunities (529 plans, etc.)
- The focus of Congress for Lame-duck session and Q1 2023 is unknown, but flexibility in planning will continue to be a must!

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Contact the Presenter

Kate Stewart
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Kate has experience providing tax and business advisory services. She enjoys working with business owners and key personnel to assist with various tax matters including tax planning, tax compliance, cost segregation studies, research and development tax credits, business growth, and succession planning.

Kate works with an extensive range of industries, including construction, real estate, distribution, and manufacturing. As an active member of Kreischer Miller's Construction Industry Group, Kate assists clients throughout the year with maximizing their tax savings and planning for future needs. She also develops internal and external professional training along with up-to-date tax alerts related to the construction industry.

Kate serves as a career counselor to Kreischer Miller team members to help them navigate their career paths and develop their skills. Kate is also involved in the firm's recruitment and retainment efforts.

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Brad provides tax services including compliance, planning, and research for multi- state corporations, partnerships, trusts, and high-net-worth individuals. He has a diversified range of experience providing services to a variety of companies in the construction, manufacturing, real estate, distribution, and service industries. He has assisted companies with business transactions, including acquisitions, sales, and reorganization transactions.

Brad is a member of Kreischer Miller's Construction Industry Group, where he assists in developing and presenting professional internal and external trainings related to the construction industry. As an advisor to his clients, Brad uses his construction industry experience to assist contractors in utilizing available tax deductions and incentives and effectively managing cash flows for income tax purposes.

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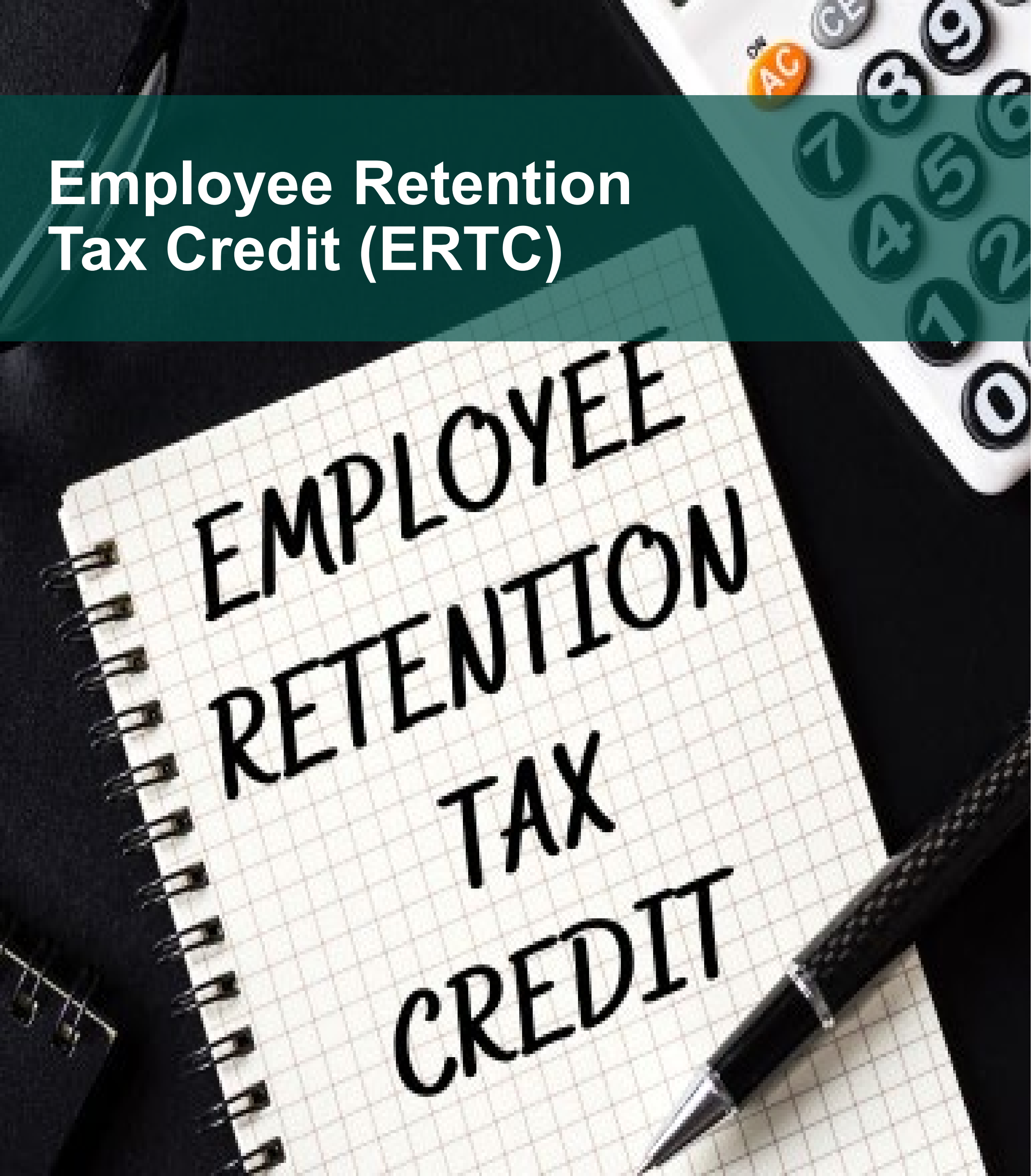
Employee Retention Tax Credit (ERTC)



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What is the Employee Retention Tax Credit?

- The Employee Retention Credit is a **fully refundable payroll tax** credit for employers equal to 50% **(2020)** or 70% **(2021)** of **qualified wages** (up to a $10,000 cap) that **Eligible Employers** pay their employees.
- Businesses qualify based on a decline in gross receipts or full/partial shutdown of their business.
- The credit is based on wages paid after March 12, 2020, and before September 30, 2021.
- The maximum credit amount with respect to **EACH EMPLOYEE** is $5,000 **per year** **(2020)** or $7,000 **per quarter** **(2021)**.
- For-profit and tax-exempt organizations qualify.

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What Every Business Needs to Evaluate

1. Did your business experience a 50% reduction in gross receipts in any quarter of 2020 compared to the same quarter in 2019?
2. Was your business required to be partially or fully shut down under a state or local order at any time from March 12, 2020 to September 30, 2021?
3. How many full-time employees did your business have in 2019?
4. Did your business experience a 20% reduction in gross receipts in the 4th quarter of 2020 compared to the 4th quarter of 2019?
5. Did your business experience a 20% reduction in gross receipts in either the 1st, 2nd, or 3rd quarters of 2021 compared to those same quarters in 2019?

***Aggregation rules apply to commonly owned businesses (revenue decline, operations suspension and total number of employees).**

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What is the Employee Retention Tax Credit?

- Credits can still be taken on Form 941X and a refund claimed. The statute of limitations to file the amended return is 3 years from the originally filed return.
- A cost to the credit is that the deduction for the covered salaries must be reduced in the year they are deducted. This means that if Forms 941X are filed for refunds for periods in 2021, the 2021 tax return must be amended and the corresponding deductions reduced.
- While the American Rescue Plan extended the ERTC to all 4 quarters of 2021, the Infrastructure Bill eliminated the credit for the 4th quarter of 2021, except for a Recovery Startup Business.

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What is Considered a Shutdown?

- **Full Shutdown** – Cessation of all business operations of the company (and per IRS guidance, aggregated businesses) due to a governmental order.
- **Partial Shutdown**
  - Reduced Operations: Reductions in hours due to a government order (e.g., to do required cleaning); or having hours of operation limited by a government order (e.g., bars)
  - IRS says that the business must be more than nominally impacted by the suspension or modification. In addition, the business cannot be able to continue “comparable operations” through telework.
  - Subjective facts and circumstances analysis must be done.

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IRS Audit Risk

- Statute of Limitations to audit the credit has increased from 3 to 5 years
- More agents are being assigned to review refund claims
- IRS has issued a warning to the public on aggressive ERC Firms and provided a procedure for the public to report these firms
- This has caused delays for the IRS issuing the refunds

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Carlo has a wide range of experience providing tax and business advisory services to privately-held companies in various industries including manufacturing, distribution, and construction. He advises owners and key executives through the various cycles of their business related to corporate and individual tax matters (i.e., growth, maturity, exit) and represents them in front of the IRS.

Carlo specializes in tax compliance and strategic planning. As the firm's Construction Industry Group Co-Leader, he forms relationships with and educates construction companies and trade organizations in the region on tax matters that impact the industry and their businesses. Carlo's extensive experience in business and tax-related topics has earned him the opportunity to present at external industry events on a regular basis. He also oversees the firm's internal tax training programs.

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2022 Business Tax Updates

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Agenda

1. 2022 tax law changes
    1. R&D Expenses
    2. Interest expense limitations
    3. Depreciation
2. LIFO – is it right for your business?

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Upcoming Tax Law Change

Research and Development Expenses

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Tax Treatment R&D – 2022 Tax Returns

Qualifying Activities	Qualifying Expenses	Tax Impact – Current Law
- Permitted Purpose - Technological in nature - Elimination of Uncertainty - Process of Experimentation	- Salaries and Wages - Supplies - Contractor Costs - Allocable SG&A Costs	- ~5-10% of qualifying expenses generate federal tax credit - State tax credits potentially available - Costs amortizable

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Tax Treatment R&D – 2022 Tax Returns

- In 2017, in an attempt to offset the revenue lost from cutting the U.S. corporate tax rate to 21% from 35%, Congress included in The Tax Cuts and Jobs Act a provision **to require companies to capitalize and amortize R&D expenses**, beginning January 1, 2022.
- Governed by IRC Section 174 – **NOT CLEARLY DEFINED**
- Expenses incurred **WITHIN** the U.S. – 5 year amortization using mid-year convention
- Expenses incurred **OUTSIDE** the U.S. – 15 year amortization using mid-year convention
- Amortization continues **EVEN IF** an R&D project is abandoned
- For tax years beginning **after December 31, 2021**
- **May result in significant book-tax differences and related deferred tax assets**

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Tax Treatment R&D – Example

- Assume that during 2022 ABC Company incurs $1,000,000 of IRC Section 174 R&D expenses.

Year	GAAP Books	Tax Return	Difference
12/31/2022	$ 1,000,000	$ 100,000	$ 900,000
12/31/2023		$ 200,000	$ (200,000)
12/31/2024		$ 200,000	$ (200,000)
12/31/2025		$ 200,000	$ (200,000)
12/31/2026		$ 200,000	$ (200,000)
12/31/2027		$ 100,000	$ (100,000)
Total	$ 1,000,000	$ 1,000,000	$ -

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Tax Treatment R&D – Impacted Areas

- Cash flow planning for 2022 tax payments
- R&D tax credits
- State response
- Interest expense limitations under IRC Section 163(j)
- Impact effective tax rates if a valuation allowance is required for the deferred tax assets
- Foreign taxes (BEAT, GILTI, FDII)

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Tax Treatment R&D

- What has been the reaction of U.S. businesses?
- How could Congress take action?
- **Action steps?**
  - Because it is not clear when or if this Section 174 capitalization provision will be deferred by Congress, taxpayers will need to begin to determine its impact for 2022.
  - Taxpayers will be required to establish a methodology for identifying and tracking all R&D expenditures based on the new capitalization requirement under Section 174. This will likely be a significant undertaking for taxpayers to comply with the TCJA changes based on the broad and subjective nature of these provisions.

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Upcoming Tax Law Change

Interest Expense Limitation

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Changes to Interest Expense Limitations

2021 Law	2022 Law
Taxable Income	Taxable Income
ADDBACK: Interest Expense	ADDBACK: Interest Expense
ADDBACK: Depreciation	~~ADDBACK: Depreciation~~
ADDBACK: Amortization	~~ADDBACK: Amortization~~
ADDBACK: Depletion	~~ADDBACK: Depletion~~
Adjusted Taxable Income	**Adjusted Taxable Income**
* 30%	* 30%
Interest Expense Limitation	**Interest Expense Limitation**

Upcoming Tax Law Change

Depreciation

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Depreciation Changes

- Current Law
  - Bonus depreciation allows for 100% expensing of eligible property
- Changes on the horizon – After **<u>December 31, 2022</u>**, the deduction for first-year bonus depreciation changes according to the following schedule:
  - 80% for property placed in service between January 1, 2023 and December 31, 2023.
  - 60% for property placed in service between January 1, 2024 and December 31, 2024.
  - 40% for property placed in service between January 1, 2025 and December 31, 2025.
  - 20% for property placed in service between January 1, 2026 and December 31, 2026

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LIFO – Is it Right for Your Business?

What is LIFO?

- LIFO: Last in, first out
- This inventory valuation method assumes that the most recent products (produced or purchased at **inflated costs**) are sold first (before products produced or purchased at **lower costs**). The price paid for the more recent products is used in the cost of goods sold calculation, producing substantial tax savings
- An **annual** calculation is performed to recompute cost of goods sold and ending inventory for both book and tax purposes
- Can result in a permanent tax savings

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LIFO – Why Now?

- Persistent inflation during 2021 and 2022 makes LIFO an attractive option to reduce book and taxable income
- LIFO can increase a company's cash flow by reducing tax liability
- Inventory is often one of the largest assets a company has on their books
- LIFO is an annual adjustment that does not impact the day-to-day operations of the entity
- Adoption and yearly calculations require a minimal time investment

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LIFO – Quantifying the Tax Savings

Taxpayer Industry	Estimated 2022 Inflation	Prior Year Inventory Value	Estimated Year 1 LIFO Reserve	Estimated savings (assume 40% tax rate)
Fabricator of custom gaskets	30%	$ 9,000,000	$ 2,700,000	$ 1,080,000
Equipment retailer	15%	$ 20,000,000	$ 3,000,000	$ 1,200,000
Fertilizer manufacturer	18%	$ 35,000,000	$ 6,300,000	$ 2,520,000
Office furniture retailer	10%	$ 5,000,000	$ 500,000	$ 200,000

LIFO – Quantifying the Tax Savings

	With LIFO	Without LIFO
Revenue	$ 50,000,000	$ 50,000,000
Cost of Goods Sold	$ (35,800,000)	$ (35,000,000)
Operating Expenses	$ (3,000,000)	$ (3,000,000)
Taxable Income	$ 11,200,000	$ 12,000,000
Income Taxes @ 40%	$ 4,480,000	$ 4,800,000
Additional Cash Flow	$ 320,000	

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Andrew provides a variety of practical tax strategies & services including tax compliance, tax planning and tax research for corporations, multi-state companies, partnerships, trusts and high-net-worth individuals. Andrew has a diversified range of experience providing tax services to a variety of real estate, distribution, manufacturing and professional services industries. He also is actively involved with the firm's Employee Stock Ownership Plan (ESOP) Group.

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Brian has a wide range of experience providing domestic and international tax planning and compliance services to a variety of middle market companies and entrepreneurial businesses in a number of industries, including manufacturing, distribution, media, real estate, financial, and professional services. He has also assisted companies with business transactions, including mergers, acquisitions and transition planning. He has significant experience in federal, state, and local tax audits, settlements, and appeals.

As an advisor to his clients, Brian uses his experience within the manufacturing industry to ensure all tax incentives are being considered. Some of these incentives include federal and state research and development tax credits, utility sales tax exemptions and, for those domestic manufacturing clients with significant exports, the Interest Charge Domestic International Sales Corporation (IC-DISC).

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Estate And Gift Planning

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Agenda

1. Gift Planning Annual Exemptions
2. Lifetime Estate and Gift Exemption
3. Portability Election
4. Grantor Trust Swap Provisions
5. Spousal Limited Access Trust

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Non-Taxable Gifts

- General rule gifts are taxable except for the following:
  - Gifts that are not more than the annual exclusion for the calendar year
  - A gift to cover someone's education tuition, if paid directly to the educational institution (does not cover room and board, books or supplies)
  - Gifts to cover someone's medical expenses, if paid directly to the medical facility
  - Gifts to your spouse if they're a U.S. citizen
  - Gifts to a political organization for its use

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Annual Exclusion For Gifts

2022 Limits:

- Annual per Donee **$16,000**;
- Annual per Donee from 2 spouses **$32,000**

2023 Limits:

- Annual per Donee **$17,000**;
- Annual per Donee from 2 spouses **$34,000**

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Lifetime Estate and Gift Exemption

- Generally, the value of assets you can gift during your lifetime or exempt from your estate.
- What you utilize during your life reduces the amount available at death.
- For 2022 the amount is **$12,060,000** (up $360,000 from 2021). If married, you and spouse can give up to **$24,120,000**.
- For 2023 the amount is **$12,920,000** (up $860,000 from 2022). If married, you and your spouse can give up to **$25,840,000**.
- Expected to go even higher in 2024 and 2025 due to inflation.
- Sunset provision in 2026. Reverts to approximately **$6,000,000.**

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Portability Election

- Portability is the ability to take the unused lifetime exemption of a deceased spouse and add it to yours.
- You must file an estate tax return for the decedent within the time prescribed by law including extensions.
- This is important.

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Portability Example Facts

- Married couple, Spouse A and Spouse B, have total assets of $12,000,000. Their assets are owned jointly. Their wills leave everything to the other spouse when one spouse dies.
- Spouse A passes away in 2022. No estate return is required since Spouse A does not have taxable assets.
- Spouse B passes away in 2026 when the exemption decreases to $6,000,000.

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Portability Example – No Portability Election

- Spouse B inherited all the assets at Spouse A's passing. Spouse B now has assets valued at $12,000,000 (we are assuming no growth in the assets, no congressional action, etc.)
- Spouse B has a taxable estate of $6,000,000 ($12,000,000 assets less $6,000,000 exemption). Spouse B's estate will pay $2,400,000 in estate tax (40% tax rate).

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Portability Example – Portability Election

- An estate tax return is filed for Spouse A and the portability election is made for the $12,060,000 that was not utilized by Spouse A.
- When Spouse B passes in 2026, they not only have the $6,000,000 exemption they are entitled to, but they also have the $12,060,000 of exemption not utilized by Spouse A for a total of $18,060,000.
- Spouse B's estate no longer has a tax liability since the exemption of $18,060,000 exceeds the estate value of $12,000,000.

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Extension of Time For Portability Election

Rev. Proc. 2022-32

- Relief to make a late portability election may be granted if the following requirements are met:
  - Decedent was survived by a spouse, died after December 31, 2010 and was a citizen of the United States;
  - The Executor is not required to file an estate tax return;
  - The Executor has not filed a timely estate tax return; and
  - The Executor files a complete and properly prepared Form 706 by the fifth annual anniversary of the Decedent's death.

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Gifting – Now is the Time

- Lifetime exemption is currently high
- Lifetime exemption set to be reduced in 2026
- No claw back when exemption is reduced
- Unknown whether congress will pass legislation prior to 2026
- Current economic downturn; depressed asset values allow greater amount to be given away
- Future appreciation of gifted assets not included in estate
- In certain circumstances, value of gifted assets can be discounted anywhere from 15% to 45%
- If stay below the exemption amount, may limit a challenge from the IRS

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Grantor Trust Swap Powers

- Many of you have grantor trusts. You as the grantor are taxed on the income of the trust and the trust is not included in your estate.
- Most, if not all grantor trusts have a power of substitution. What this means is that the grantor can swap assets in the trust with assets of equal value without causing any of the asset value to be included in the gross estate for estate tax purposes.

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Grantor Trust Swap Powers – Examples

- In a down market, may want to substitute assets with greater appreciation potential with assets in the trust with less growth potential.
- May want to take out of the trust a highly appreciated asset with a low basis by substituting cash or property with a high basis. Once the asset with the low basis is out of the trust, it is eligible to receive a step-up in basis at death.

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Grantor Trust Swap Powers – Illustration

- Assume real estate purchased for $300,000 and valued at $1,800,000 is transferred to an irrevocable grantor trust which provides for a power of substitution.
- This will remove $1,800,000 from the grantor's estate. However, the asset has a carryover basis of $300,000, so if that asset is sold after the grantor's death, the trust will pay capital gains tax on the $1,500,000 of gain.
- Let's assume the grantor utilizes the power of substitution prior to their death, by transferring cash of $1,800,000 to the trust in exchange for the real estate valued at $1,800,000. At the grantor's death, the real estate qualifies for a step-up in basis. The basis in the real estate would be stepped up to its fair market value of $1,800,000, allowing the heirs to sell the real estate for $1,800,000 with no gain or loss, thereby saving the capital gains tax.

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Spousal Lifetime Access Trust (SLAT)

What if you want to use up your exemption but you want the ability to get the money back if you need it. Consider a SLAT.

- Locks in gifts up to exemption of $12.06 million
- Avoids estate tax on assets and appreciation upon the death of both spouses
- Income and principal can be paid to the beneficiary spouse (grantor spouse indirectly)

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Spousal Lifetime Access Trust (SLAT)

- Married couple
- Spouse (A) with assets in their own name transfers assets to the trust for the benefit of the other spouse (B) and children
- Permits spouse (B) to have access to the income
- Must name an independent trustee
- Trust is attractive because of the control of the cash flow
- Grantor trust; grantor pays tax on the income
- May also create a SLAT for each spouse
  - Cannot be identical
  - Must avoid the Reciprocal Trust Doctrine

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Spousal Lifetime Access Trust (SLAT)

Disadvantages

- Beneficiary spouse dies first
- Beneficiary spouse divorces you
- Complex set of rules that have to be followed

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Congressional Action

- Uncertain if any changes will be made by Congress prior to 2026.
- President Biden's proposals, which he has not been able to get passed into law, would eliminate a lot of which we discussed today.
- There is a window of opportunity here. You should be reviewing your estate plan with your advisors.

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Contact the Presenter

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Rich has extensive experience providing domestic and international tax strategies, planning and services to a variety of middle market companies and entrepreneurial businesses in a number of industries including manufacturing, distribution, real estate, financial, and professional services. He also has significant experience and expertise with high-net-worth individuals, investment companies and pass-through entities and has been involved in federal, state, and local tax audits, settlements, and appeals.

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State and Local Tax Highlights

**Thomas Frascella,
Director, Tax Strategies,
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Group Leader**

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Agenda

State and Local Tax Highlights

- PA notable changes
- Delaware unclaimed property reform
- Income tax nexus
  - New Frontier – Multistate Tax Commission (MTC) Statement on PL 86-272
- Sales tax update
- Trends

PA Budget Highlights

- Phased in corporate income tax rate reduction beginning in 2023
  - Reduction calls for a 1% reduction in 2023 from 9.99% to 8.99% and a half point each year thereafter until the rate reaches 4.99%
- Codification of economic nexus standard
- Codification of activities that now create substantial nexus with PA
  - Leasing and licensing of intangible property and lending activities
  - Intended to capture the intangible holding companies
- Apportionment sourcing for intangibles
  - Market based sourcing for specifically identified transactions
  - Goodwill not identified and could be subject to throw out in the numerator
- PIT IRC section 1031 conformity for property placed in service in 2023, with proceeds invested in similar property
- Increase in IRC section 179 deduction from $25,000 to $1,080,000

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PA Budget Highlights, *continued*

- PIT IRC section 1031 conformity for property placed in service in 2023, with proceeds invested in similar property
- Increase in IRC section 179 deduction from $25,000 to $1,080,000
- Budget did not include the adoption of a PTE level tax
- No formal relief for partners in partnerships regarding the resident tax credit
- Administrative update

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Delaware

- Delaware enacted sweeping changes to its unclaimed property law
- Most significant change is the removal of the "reason to believe" requirement – greatly expands the state's audit powers
- Delaware incorporated entities should evaluate their filing and reporting history
- Non-compliance should be addressed for possible remediation

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Income Tax Nexus and MTC Statement on P.L. 86-272

- Income tax protection hinges on one word “solicitation”
  - States want to define the term very narrowly
  - Taxpayers tend to think everything is related to solicitation one way or another
- The MTC Statement is just an interpretation
- Puts businesses on notice that their non-filing or PL 86-272 filing positions may be scrutinized
- Focus is on internet activities
  - Providing post sale assistance through chat or email through the website
  - Solicitation or receiving online credit card applications
  - Placing cookies used for product development/product management on electronic devices of customers
  - Allowing candidates to apply for job openings online

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Sales Tax Update

Characterization

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Sales Tax Update

***Hegar v. Black, Mann, & Graham LLP*, 2022 Tex. App. LEXIS 1311, 2022 WL 567853 (2/25/2022)**

- Issue: Whether the services the taxpayer purchased were taxable data processing services or nontaxable legal services.
- Background: Black, Mann, & Graham (BMG) is a law firm specializing in residential mortgage services. BMG purchased loan packages from its vendors and resold those packages to lenders. The Comptroller assessed sales tax for 2014-2018, claiming the services were data-processing services. BMG claims the services were nontaxable legal services.
- Holding and result: Tex. Admin. Code § 3.330(a)(1) does not create a two-part test as alleged by BMG. The essence of the transaction was the provision of data processing services. The decision of the trial court was reversed, and the refund denied.

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Sales Tax Update

Cincinnati Federal Savings & Loan Co. v. McClain, slip op. No. 2022-Ohio-725 (Ohio Mar. 15, 2022)

- Issue: Whether the services the taxpayer purchased were taxable "automatic data processing" or "electronic information services" or nontaxable "personal or professional services" and whether the true object test applied.
- Background: Cincinnati Federal Savings & Loan purchased "computerized services" from a vendor. Cincinnati paid sales tax to its vendor and claimed a refund of the tax paid from 2013 – 2015, arguing the services were data processing services.

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Sales Tax Update

Cincinnati Federal Savings & Loan Co. v. McClain, (continued)

- Holding and Result: The transactions were mixed transactions because the vendor provided at least some customization of the product for Cincinnati Federal's needs. The true object test must be applied to a mixed transaction. The Court remanded for application of the true object test. The Court held that if there is not a mixed transaction at all, the true object test is not applied. In general, the court stated that exempt services are those provided by a person, rather than by a computer.
- Status: Remanded for application of the true object test to the transactions involving customized software.

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Sales Tax Update

Enacomm, Inc. v. Hegar, Cause No. D-1-GN-20-001910, Travis County, Texas, 419th Judicial District (settled April 2022)

- Enacomm is a provider of Interactive Voice Response ("IVR") services, also known as call center services for customers like banks, utilities, and pharmacies. Enacomm uses servers, software applications, and internet and telecom networks to provide a platform for Enacomm's customers to interface with their clients, usually in the form of a digitized voice providing instructions according to pre-set preferences.
- Enacomm's position is that it serves the same function as a human customer service representative would. The only difference is that digitized voice messages are pre-recorded and delivered via software applications. However, no data from Enacomm's customers is stored or processed on Enacomm's servers. No data is processed.
- Enacomm characterizes its product as nontaxable automated call center services. Any data processing is incidental to the true service performed.
- Enacomm's payment after protest lawsuit includes constitutional due process and equal protection claims.

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Sales Tax Update

Landis+Gyr Midwest, Inc. v. Washington Dep't of Revenue, Washington Court of Appeals, Case No. 568772 (pending litigation)

- The Department assessed sales tax on L&G's automated meter reading services, which transmits data to Puget Sound Energy, contending that such services constituted taxable "digital automated services" (DAS).
- L&G argued that its services were excluded from tax as it meets the statutory definition "data processing services" i.e., primarily automated, provided to a business, the primary object of which is the performance of operations on data provided by the customer, and to convert the data to usable information.
- L&G paid the sales tax assessed by the Department and sought a refund in the Thurston County Superior Court. The Court granted the Department's motion for summary judgment and L&G appealed to the Washington Court of Appeals.
- On appeal, L&G also asserts ITFA preemption.

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Sales Tax Update

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Contact the Presenter

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Tom has a wide range of experience providing state and local tax strategies & services in the areas of income/franchise, sales and use, realty transfer, and unclaimed property taxes to a variety of businesses, including multi-state and multi-national businesses in the light and heavy manufacturing, distribution, life sciences, not-for-profit and professional services industries. He helps businesses address their multi-state tax needs.

As an experienced multi-state tax professional, Tom has developed a solid understanding of the issues and concerns of growing middle market companies and large publicly-traded enterprises and has been proactive in anticipating their issues and developing solutions to minimize administrative burdens and tax exposures.

He has also assisted clients with navigating the complex state and local tax issues associated with significant entity life events, such as acquisitions, dispositions, or liquidations. His experience working with clients during restructurings has allowed Tom to gain an appreciation of the operational issues associated with these events to address issues in a direct manner and to make adjustments to achieve the anticipated operational and tax efficient project goals. Tom is widely recognized for his expertise in Pennsylvania and Philadelphia tax matters.

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