

YEAR-END TAX PLANNING

FOR BUSINESSES



U.S. BUSINESSES ARE FACING PRESSURE

to drive revenue, manage costs and increase shareholder value, all while surrounded by economic and political uncertainties. Disruptions to supply chains brought about by the pandemic have continued into 2022. Inflation and rising interest rates have made the cost of debt, goods and services more expensive and cooled consumer spending. The stock market has declined sharply, and the prospect of a recession is on the rise. What's more, the outcomes of the upcoming November U.S. congressional elections — which as of the publication of this article are as yet unknown — will shape future tax policies. How do businesses thrive in uncertain times? By turning toward opportunity, which includes proactive tax planning. Tax planning is essential for U.S. businesses looking for ways to optimize cash flow while minimizing their total tax liability over the long term.

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RECENT LEGISLATIVE CHANGES

THE INFLATION REDUCTION ACT AND THE CHIPS ACT

This article provides a checklist of areas where, with proper planning, businesses may be able to reduce or defer taxes over time. Unless otherwise noted, the information contained in this article is based on enacted tax laws and policies as of the publication date and is subject to change based on future legislative or tax policy changes.

As the U.S. entered 2022,

Major proposed federal legislation that sought to raise taxes on large profitable corporations and high-income individuals (the Build Back Better Act) had died in the Senate. Although not nearly as broad in terms of tax increases, the Inflation Reduction Act (IRA) was enacted on August 16, 2022. Tax-related provisions in the IRA include:

- A 15% alternative minimum tax (AMT) on the adjusted financial statement income of certain large corporations (also referred to as the “book minimum tax” or “business minimum tax”), effective for tax years beginning after December 31, 2022.
- A 1% excise tax on corporate stock buybacks, which applies to repurchases made by public companies after December 31, 2022.
- Modification of many of the current energy-related tax credits and the introduction of significant new credits, including new monetization options.
- A two-year extension of the section 461(l) excess business loss limitation rules for noncorporate taxpayers, which are now set to expire for tax years beginning after 2028



CORPORATE AMT



The AMT is 15% of the adjusted financial statement income (AFSI) of an applicable corporation less the corporation's AMT foreign tax credit. An applicable corporation is a corporation (other than an S corporation, a regulated investment company or a real estate investment trust) whose average annual AFSI exceeds \$1 billion for the prior consecutive three years. The AMT can also apply to a foreign-parented multinational group that meets the \$1 billion AFSI test and whose net income in the U.S. equals or exceeds \$100 million on average over the same three-year period.

- Large corporations that may be subject to the AMT for 2023 will need to estimate their AFSI for tax years 2020, 2021 and 2022. Once a corporation is an applicable corporation, it remains an applicable corporation for all subsequent tax years.
- The rules for determining applicable corporations and calculating AFSI are complex and require Treasury to issue regulations and/or other guidance. When calculating AFSI, special aggregation rules apply to controlled groups and trades or businesses (including partnerships or a share of partnership income) under common control.
- Corporations that are subject to the AMT should be sure to consider the tax when making tax planning decisions.



EXCISE TAX ON STOCK BUYBACKS

The 1% excise tax is imposed on U.S. public companies. The tax is 1% of the fair market value of any stock repurchased by a corporation during any taxable year ending after 2022, net of the fair market value of any new stock issued by the corporation during the taxable year. The IRA provides exceptions for certain repurchases (i.e., where the repurchased amount does not exceed \$1 million or where the repurchased amount is treated as a dividend for income tax purposes). The tax extends to certain affiliates of U.S. corporations, as well as specified affiliates of foreign corporations performing buybacks on behalf of their parent organization.

- Corporations planning taxable stock buybacks should consider executing repurchases by December 31, 2022 to avoid the 1% excise tax.

TAX CREDITS



The IRA includes the largest-ever U.S. investment committed to combat climate change, providing energy security and clean energy programs over the next 10 years. Overall, the IRA modifies many of the current green energy credits and introduces significant new credits. Notably, the IRA also introduces new options for monetizing the credits, including the ability for taxable entities to elect a one-time transfer of all or a portion of certain tax credits to other taxpayers for cash.

The CHIPS Act, enacted on August 9, 2022, provides for a new 25% advanced manufacturing investment credit for investments in semiconductor manufacturing and for the manufacture of certain equipment required in the semiconductor manufacturing process.

[For more information on the green energy credits and the advanced manufacturing investment credit, see Claim Available Tax Credits, below.](#)

Generate cash savings through tax accounting method changes and strategic tax elections

Adopting or changing income tax accounting methods can provide taxpayers with valuable opportunities for timing the recognition of items of taxable income and expense, which determines when cash is needed to pay federal tax liabilities.

In general, accounting methods can either result in the acceleration or deferral of an item or items of taxable income or deductible expense, but they do not alter the total amount of income or expense that is recognized during the lifetime of a business. As interest rates continue to rise and debt becomes more expensive, many businesses want to preserve their cash, and one way to do this is to defer their tax liabilities through their choice of accounting methods.

TAX STRATEGIES

Companies that want to reduce their 2022 tax liability should consider traditional tax accounting method changes, tax elections and other actions for 2022 to defer recognizing income to a later taxable year and accelerate tax deductions to an earlier taxable year, including the following:

- **Changing from recognizing certain advance payments** (e.g., upfront payments for goods, services, gift cards, use of intellectual property, sale or license of software) in the year of receipt to recognizing a portion in the following taxable year.
- **Changing from the overall accrual to the overall cash method of accounting** (i.e., where accounts receivable exceed accounts payable and accrued expenses).
- **Changing from capitalizing certain prepaid expenses** (e.g., insurance premiums, warranty service contracts, taxes, government permits and licenses, software maintenance) to deducting when paid using the “12-month rule.”
- **Deducting eligible accrued compensation liabilities** (such as bonuses and severance payments) that are fixed and determinable by the end of the year and paid within 2.5 months of year end.
- **Accelerating deductions of liabilities** such as warranty costs, rebates, allowances and product returns, state income and franchise taxes, and real and personal property taxes under the “recurring item exception.”
- **Purchasing qualifying property and equipment before the end of 2022** to take advantage of the 100% bonus depreciation provisions (before bonus depreciation begins to gradually phase out starting in 2023) and the Section 179 expensing rules.
- **Deducting “catch-up” depreciation** (including bonus depreciation, if previously missed) of **personal property** by changing to shorter recovery periods or changing from non-depreciable to depreciable.
- **Optimizing inventory valuation methods.** For example, adopting, or making changes within, the last-in, first-out (LIFO) method of valuing inventory generally will result in higher cost of goods sold deductions as costs are increasing.
- **Changing from amortizing commissions paid to employees** to deducting in the year paid or incurred under the simplifying conventions.
- **Electing to deduct 70% of success-based fees paid or incurred in 2022** in connection with certain acquisitive transactions under Rev. Proc. 2011-29. Other transaction costs that are not inherently facilitative may also be deductible. Taxpayers that incur transaction costs should consider undertaking a transaction cost study to maximize their tax deductions.
- **Electing the de minimis safe harbor** to deduct small-dollar expenses for the acquisition or production of property that would otherwise be capitalizable under general rules.

TREATMENT OF R&E EXPENSES



Under the 2017 Tax Cuts and Jobs Act (TCJA), research and experimental (R&E) expenditures incurred or paid for tax years beginning after December 31, 2021 will no longer be immediately deductible for tax purposes. Instead, businesses are required to capitalize and amortize R&E expenditures over a period of five or 15 years beginning in 2022. The mandatory capitalization rules also apply to software development costs, including software developed for internal use. The new rules present additional considerations for businesses that invest in R&E.



IS “REVERSE” PLANNING BETTER FOR YOUR SITUATION?

Depending on their facts and circumstances, some businesses may instead want to accelerate taxable income into 2022 if, for example, they believe tax rates will increase in the near future or they want to optimize use of NOLs. These businesses may want to consider “reverse” planning strategies, such as:

- Implementing a variety of “reverse” tax accounting method changes, such as changing to recognize advance payments in the year of receipt or changing to deduct certain tax liabilities (state income, state franchise, real and personal property taxes, payroll taxes) when paid.
- Selling and leasing back appreciated property before the end of 2022, creating gain that is taxed currently offset by future deductions of lease expense, being careful that the transaction is not recharacterized as a financing transaction.
- Accelerating taxable capital gain into 2022.
- Electing out of the installment sale method for installment sales closing in 2022.
- Delaying payments of liabilities whose deduction is based on when the amount is paid, so that the payment is deductible in 2023 (e.g., paying year-end bonuses after the 2.5-month rule).

TAX ACCOUNTING METHOD CHANGES - IS A FORM 3115 REQUIRED AND WHEN?



Some of the opportunities listed above for changing the timing of income recognition and deductions require taxpayers to submit a request to change their method of tax accounting for the particular item of income or expense. Generally, tax accounting method change requests require taxpayers to file a Form 3115, Application for Change in Accounting Method, with the IRS under one of the following two procedures:

- The “automatic” change procedure, which requires the taxpayer to attach the Form 3115 to the timely filed (including extensions) federal tax return for the year of change and to file a separate copy of the Form 3115 with the IRS no later than the filing date of that return; or
- The “nonautomatic” change procedure, which applies when a change is not listed as automatic and requires the Form 3115 (including a more robust discussion of the legal authorities than an automatic Form 3115 would include) to be filed with the IRS National Office during the year of change along with an IRS user fee. Calendar year taxpayers that want to make a nonautomatic change for the 2022 taxable year should be cognizant of the accelerated December 31, 2022 due date for filing Form 3115.

Tax accounting method changes generally allow for the recognition of unfavorable changes over four years while allowing the full amount of any favorable changes in the year of the change.

Write-off bad debts and worthless stock

While the economy attempts to recover from the challenges brought on by the COVID-19 pandemic, inflation and rising interest rates, businesses should evaluate whether losses may be claimed on their 2022 returns related to worthless assets such as receivables, property, 80% owned subsidiaries or other investments.

- **Business bad debts can be wholly or partially written off for tax purposes.** A partial write-off requires a conforming reduction of the debt on the books of the taxpayer; a complete write-off requires demonstration that the debt is wholly uncollectible as of the end of the year.
- **Losses related to worthless, damaged or abandoned property** can sometimes generate ordinary losses for specific assets.
- **Businesses should consider claiming losses** for investments in **insolvent subsidiaries** that are at least 80% owned and for certain investments in insolvent entities taxed as partnerships (also see Partnerships and S corporations, below).



Maximize interest expense deductions

The TCJA significantly expanded Section 163(j) to impose a limitation on business interest expense of many taxpayers, with exceptions for small businesses (those with three-year average annual gross receipts not exceeding \$27 million for 2022), electing real property trades or businesses, electing farming businesses and certain utilities.

- **The deduction limit is based on 30% of adjusted taxable income.** The amount of interest expense that exceeds the limitation is carried over indefinitely.
- Beginning with 2022 taxable years, taxpayers will no longer be permitted to add back deductions for depreciation, amortization and depletion in arriving at adjusted taxable income (the principal component of the limitation).

Maximize tax benefits of NOLs

Net operating losses (NOLs) are valuable assets that can reduce taxes owed during profitable years, thus generating a positive cash flow impact for taxpayers. Businesses should make sure they maximize the tax benefits of their NOLs.

- For tax years beginning after 2020, NOL carryovers from tax years beginning after 2017 are limited to 80% of the excess of the corporation's taxable income over the corporation's NOL carryovers from tax years beginning before 2018 (which are not subject to this 80% limitation, but may be carried forward only 20 years). If the corporation does not have pre-2018 NOL carryovers, but does have post-2017 NOLs, the corporation's NOL deduction can only negate up to 80% of the 2022 taxable income with the remaining subject to the 21% federal corporate income tax rate. Corporations should monitor their taxable income and submit appropriate quarterly estimated tax payments to avoid underpayment penalties.
- Corporations should monitor their equity movements to avoid a Section 382 ownership change that could limit annual NOL deductions.
- Losses from pass-throughs entities must meet certain requirements to be deductible at the partner or S corporation owner level (also see Partnerships and S corporations, below).

Defer tax on capital gains

Tax planning for capital gains should consider not only current and future tax rates, but also the potential deferral period, short and long-term cash needs, possible alternative uses of funds and other factors.

Noncorporate shareholders are eligible for exclusion of gain on dispositions of Qualified Small Business Stock. For other sales, businesses should consider potential long-term deferral strategies, including:

- Reinvesting capital gains in Qualified Opportunity Zones.
- Reinvesting proceeds from sales of real property in other "like-kind" real property.
- Selling shares of a privately held company to an Employee Stock Ownership Plan.

Businesses engaging in reverse planning strategies (see *Is "reverse" planning better for your situation?* above) may instead want to move capital gain income into 2022 by accelerating transactions (if feasible) or, for installment sales, electing out of the installment method.



CLAIM AVAILABLE TAX CREDITS



The U.S. offers a variety of tax credits and other incentives to encourage employment and investment, often in targeted industries or areas such as innovation and technology, renewable energy and low-income or distressed communities. Many states and localities also offer tax incentives. Businesses should make sure they are claiming all available tax credits.

- The **Employee Retention Credit (ERC)** is a refundable payroll tax credit for qualifying employers that were significantly impacted by COVID-19 in 2020 or 2021. For most employers, the compensation eligible for the credit had to be paid prior to October 1, 2021. However, the deadline for claiming the credit does not expire until the statute of limitations closes on Form 941. Therefore, employers generally have three years to claim the ERC for eligible quarters during 2020 and 2021 by filing an amended Form 941-X for the relevant quarter. Employers that received a **Paycheck Protection Program (PPP)** loan can claim the ERC but the same wages cannot be used for both programs.
- Businesses that incur expenses related to qualified research and development (R&D) activities are eligible for the federal R&D credit.
- Small business start-ups are permitted to use up to \$250,000 of their qualified R&D credits to offset the 6.2% employer portion of social security payroll tax. The IRA doubles this payroll tax offset limit to \$500,000, providing an additional \$250,000 that can be used to offset the 1.45% employer portion of Medicare payroll tax.
- Taxpayers that reinvest capital gains in **Qualified Opportunity Zones** may be able to temporarily defer the federal tax due on the capital gains. The investment must be made within a certain period after the disposition giving rise to the gain. Post-reinvestment appreciation is exempt from tax if the investment is held for at least 10 years but sold by December 31, 2047.
- The **New Markets Tax Credit Program** provides federally funded tax credits for approved investments in low-income communities that are made through certified “Community Development Entities.”
- Other incentives for employers include the **Work Opportunity Tax Credit**, the **Federal Empowerment Zone Credit**, the **Indian Employment Credit** and credits for paid family and medical leave (FMLA).

- There are several federal tax benefits available for investments to promote energy efficiency and sustainability initiatives. The IRA extends and enhances certain green energy credits as well as introduces a variety of new incentives. Projects that have historically been eligible for tax credits and that have been placed in service in 2022 may be eligible for credits at higher amounts. Additionally, projects that begin construction under the tax rules prior to 60 days after the Department of the Treasury releases guidance on these requirements are eligible for the credits at the higher rates. Certain other projects may be eligible for tax credits beginning in 2023. The IRA also introduces prevailing wage and apprenticeship requirements in the determination of certain credit amounts, as well as direct pay or transferability tax credit monetization options beginning with projects placed in service in 2023.
- Under the CHIPS Act, taxpayers that invest in semiconductor manufacturing or the manufacture of certain equipment required in the semiconductor manufacturing process may be entitled to a 25% advanced manufacturing investment credit beginning in 2023. The credit generally applies to qualified property placed in service after December 31, 2022 and for which construction begins before January 1, 2027. Where construction began prior to January 1, 2023, the credit applies only to the extent of the basis attributable to construction occurring after August 9, 2022.

PARTNERSHIPS AND S CORPORATIONS



Partnerships, S corporations and their owners may want to consider the following tax planning opportunities:

- Taxpayers with unused passive activity losses attributable to partnership or S corporation interests may want to consider disposing of the interest to utilize the loss in 2022.
- Taxpayers other than corporations may be entitled to a deduction of up to 20% of their qualified business income (within certain limitations based on the taxpayer's taxable income, whether the taxpayer is engaged in a service-type trade or business, the amount of W-2 wages paid by the business and the unadjusted basis of certain property held by the business). Planning opportunities may be available to maximize this deduction.
- Certain tax basis, at-risk and active participation requirements must be met for losses of pass-through entities to be deductible by a partner or S corporation shareholder. In addition, an individual's excess business losses are subject to overall limitations. There may be steps that pass-through owners can take before the end of 2022 to maximize their loss deductions. The Inflation Reduction Act extends the excess business loss limitation by two years (the limitation was scheduled to expire for taxable years beginning on or after January 1, 2027).
- Under current rules, the abandonment or worthlessness of a partnership interest may generate an ordinary deduction (instead of a capital loss) in cases where no partnership liabilities are allocated to the interest. If business conditions are such that the interest does not have value or the partner is considering abandonment, important issues need to be considered.
- Following enactment of the TCJA, deductibility of expenses incurred by investment funds are treated as "investment expenses"—and therefore are limited at the individual investor level— if

the fund does not operate an active trade or business (i.e., if the fund's only activities are investment activities). To avoid the investment expense limitation, consideration should be given as to whether a particular fund's activities are so closely connected to the operations of its portfolio companies that the fund itself should be viewed as operating an active trade or business.

- Under current rules, gains allocated to carried interests in investment funds are treated as long-term capital gains only if the investment property has been held for more than three years. Investment funds should consider holding the property for more than three years prior to sale to qualify for reduced long-term capital gains rates.
- Various states have enacted PTE tax elections that seek a workaround to the federal personal income tax limitation on the deduction of state taxes for individual owners of pass-through entities. See State pass-through entity tax elections, below.
- The transition rules in the 2019 final regulations that put an end to the use of bottom-dollar guarantees by partners to create recourse tax basis in a partnership will expire on October 4, 2023. Taxpayers that currently rely on the transition rules should review their partnership liability allocations.

INTERNATIONAL OPERATIONS



Treasury issued final foreign tax credit (FTC) regulations on December 28, 2021 finalizing, with significant modifications, previously proposed regulations addressing the creditability standards for various foreign taxation amounts under the U.S. FTC system. The regulations modify long standing rules related primarily to withholding taxes on items such as royalties and services and add a standard related to a jurisdiction's transfer pricing rules needing to employ arm's length principles for in-country income taxes to be creditable.

The new standards primarily impact withholding and income taxes from certain Asian and Latin American countries. If your organization benefits from FTCs, now is the time to undertake a critical look at the jurisdictions you operate in and perform an assessment of whether taxes paid to such jurisdiction(s) are still available as FTCs.

In addition, the current economic environment has renewed the interest of many organizations to consider repatriating cash from overseas

operations. Besides gaining access to cash, there could be significant U.S. tax advantages to repatriating those profits currently. If your organization has controlled foreign corporations (CFCs) and those CFCs have undistributed previously taxed earnings and profits (PTEP) from the Section 965 transition tax, Subpart F and/or global intangible low taxed income (GILTI) from principally Euro or pound sterling functional currency entities, repatriating the PTEP could unlock deductions related to foreign exchange currency fluctuations. For instance, if the Euro or pound sterling exchange rate has strengthened in favor of the U.S. dollar compared to when undistributed PTEP was generated, repatriating such PTEP now under current exchange rates will likely generate an ordinary deduction for the difference in the amount of U.S. dollars received now versus the amount that was previously included in income. Additionally, planning to mitigate foreign withholding taxes on distributions should be considered, and there may be strategies that can help achieve both objectives.

REVIEW TRANSFER PRICING COMPLIANCE



Businesses with international operations should review their cross-border transactions among affiliates for compliance with relevant country transfer pricing rules and documentation requirements. They should also ensure that actual intercompany transactions and prices are consistent with internal transfer pricing policies and intercompany agreements, as well as make sure the transactions are properly reflected in each party's books and records and year-end tax calculations. Businesses should be able to demonstrate to tax authorities that transactions are priced on an arm's-length basis and that the pricing is properly supported and documented. Penalties may be imposed for non-compliance. Areas to consider include:

- Have changes in business models, supply chains or profitability (including changes due to the effects of inflation) affected arm's length transfer pricing outcomes and support? These changes and their effects should be supported before year end and documented contemporaneously.
- Have all cross-border transactions been identified, priced and properly documented, including transactions resulting from merger and acquisition activities (as well as internal reorganizations)?
- Do you know which entity owns intellectual property (IP), where it is located and who is benefitting from it? Businesses must evaluate their IP assets — both self-developed and acquired through transactions — to ensure compliance with local country transfer pricing rules and to optimize IP management strategies.
- If transfer pricing adjustments need to be made, they should be done before year end, and for any intercompany transactions involving the sale of tangible goods, coordinated with customs valuations.
- Multinational businesses should begin to monitor and model the potential effects of the agreement among OECD countries on a two pillar framework that addresses distribution of profits among countries and imposes a 15% global minimum tax.



Considerations for employers

Employers should consider the following issues as they close out 2022 and enter 2023:

- Employers have until the extended due date of their 2022 federal income tax return to retroactively establish a qualified retirement plan and to fund the new or an existing plan for 2022. However, employers cannot retroactively eliminate existing retirement plans (such as simplified employee pensions (SEPs) or SIMPLE plans) to make room for a retroactively adopted plan (such as an employee stock ownership plan (ESOP) or cash balance plan).
- Contributions made to a qualified retirement plan by the extended due date of the 2022 federal income tax return may be deductible for 2022; contributions made after this date are deductible for 2023.
- Employers can reimburse employees tax-free for up to \$5,250 per year in student loan debt, through Dec. 31, 2025, if the employer sets up a broad-based IRC Section 127 educational assistance plan.
- Employers seeking to attract and retain employees may offer tuition assistance to future employees by providing forgivable loan agreements. When the loans are forgiven (typically after the student has become an employee for a specified period of time), the amount forgiven is taxable wages, subject to income and employment taxes (including the employer share of employment taxes).
- The CARES Act permitted employers to defer payment of the employer portion of Social Security (6.2%) payroll tax liabilities that would have been due from March 27 through December 31, 2020. Employers are reminded that the remaining balance of the deferred amount must be paid by December 31, 2022. Notice CP256-V is not required to make the required payment.
- Employers should ensure that common fringe benefits are properly included in employees' and, if applicable, 2% S corporation shareholders' taxable wages. Partners and LLC members (including owners of capital interests and profits interests) should not be issued W-2s.
- Publicly traded corporations may not deduct compensation of "covered employees" — CEO, CFO and generally the three next highest compensated executive officers — that exceeds \$1 million per year. Effective for taxable years beginning after December 31, 2026, the American Rescue Plan Act of 2021 expands covered employees to include five highest paid employees. Unlike the current rules, these five additional employees are not required to be officers.
- Generally, for calendar year accrual basis taxpayers, accrued bonuses must be fixed and determinable by year end and paid within 2.5 months of year end (by March 15, 2023) for the bonus to be deductible in 2022. However, the bonus compensation must be paid before the end of 2022 if it is paid by a Personal Service Corporation to an employee-owner, by an S corporation to any employee-shareholder, or by a C corporation to a direct or indirect majority owner.
- Businesses should assess the tax impacts of their mobile workforce. Potential impacts include the establishment of a corporate tax presence in the state or foreign country where the employee works; dual tax residency for the employee; additional taxable compensation for remote workers' travel to a work location that is determined to be personal commuting expense; and payroll tax, benefits, and transfer pricing issues.

STATE & LOCAL TAXES

Businesses should monitor the tax laws and policies in the states in which they do business to understand their tax obligations, identify ways to minimize their state tax liabilities, and eliminate any state tax exposure. The following are some of the state-specific areas taxpayers should consider when planning for their tax liabilities in 2022 and 2023:

Nexus Rules

- Has the business reviewed the nexus rules in every state in which it has property, employees or sales to determine whether it has a tax obligation? State nexus rules are complex and vary by state. Even minimal or temporary physical presence within a state can create nexus, e.g., temporary visits by employees for business purposes; presence of independent contractors making sales or performing services, especially warranty repair services; presence of mobile or moveable property; or presence of inventory at a third-party warehouse. In addition, many states have adopted a bright-line factor-presence nexus threshold for income tax purposes (e.g., \$500,000 in sales). Also keep in mind that foreign entities that claim federal treaty protection are likely not protected from state income taxes, and those foreign entities that have nexus with a state may still be liable for state taxes.
- Has the business considered the state income tax nexus consequences of its mobile or remote workforce, including the impacts on payroll factor and sales factor sourcing? Most states that provided temporary nexus and/or withholding relief relating to teleworking employees lifted those orders during 2021. (Also see Considerations for employers, above.)
- Does the business qualify for P.L. 86-272 protection with respect to its activities in a state? For businesses selling remotely and that have claimed P.L. 86-272 protection from state income taxes in the past, how is the business responding to changing state interpretations of those protections with respect to businesses engaged in internet-based activities?

Filing methods and elections

- Is the business using the most advantageous filing method allowed by a state based on its facts and circumstances? States may require or allow a taxpayer to report on a separate company or unitary combined reporting basis, or may provide filing option elections. A state's mandatory unitary combined filing may allow a "water's edge" election or a worldwide combined group election. States have different rules for how and when to file water's edge and other reporting method elections; therefore, care should be taken that the election is filed on a timely basis.
- Where the taxpayer or a U.S. affiliate has foreign activities, or where the taxpayer has foreign affiliates, have the overseas business operations been evaluated as to whether they should be included in any water's edge unitary combined group?
- If the business's affiliated group has both loss entities and profitable entities, has the business considered making nexus consolidated return elections in states where such elections are allowed?
- Did the business make an S corporation election for federal income tax purposes, and is it required to make a separate state election (or file nonresident shareholder consents with the tax jurisdiction)?
- Does the business operate using single member LLCs or other federal disregarded entity structures, and has the tax treatment of those structures been reviewed for state-specific rules and filing requirements?

TAXABLE INCOME AND TAX CALCULATION

- Does the state conform to federal tax rules or decouple from them? Not all states follow federal tax rules. For example, many states have their own systems of depreciation, and may or may not allow federal bonus depreciation.
- Where the business receives deductible dividends, GILTI, subpart F income, or other nontaxable income, have state expense disallowance attribution rules been applied?
- Does the business have intercompany royalty or other intangible expense, interest expense, or management fees paid to a related entity that may be required to be added back in computing state taxable income?
- Has the business claimed all state NOL and state tax credit carrybacks and carryforwards? Most states apply their own NOL/credit computation and carryback/forward provisions.
- Is the business claiming all available state and local tax credits? States offer various incentive credits including, e.g., for research activities, expanding or relocating operations, making capital investments or increasing headcount.

ALLOCATION AND APPORTIONMENT

- Is the business correctly sourcing its sales of tangible personal property, services, and intangibles to the proper states? The majority of states impose single-sales factor apportionment formulas and require market-based sourcing for sales of services and licenses/sales of intangibles using disparate market-based sourcing methodologies.
- Has the business considered whether a nonbusiness or allocable income position may be appropriate and whether taking such a position would be advantageous?
- If the business holds an interest in a partnership, have the consequences with respect to factor flow-through and other potential special partnership apportionment provisions been considered?
- If the taxpayer sold assets or a business segment, including where an IRC Section 336, 338(g), or 338(h)(10) election was made, has the multistate treatment of the sale gain receipts been addressed, including with respect to goodwill?
- If the business is a manufacturer, retailer, transportation company, financial corporation, or other special industry, have state special apportionment elections or required special apportionment formulas been considered?

Other issues

- Has the business considered the state and local tax treatment of merger, acquisition and disposition transactions? Keep in mind that internal reorganizations of existing structures also have state tax impacts. There are many state-specific considerations when analyzing the tax effects of transactions.
- Has the business considered state and local transfer pricing requirements with respect to its intercompany financing and other intercompany arrangements? With rising interest rates and inflation, intercompany arrangements should be re-addressed, and intercompany transfer pricing studies may need to be updated. Also see Transfer Pricing, above.
- Has the business amended any federal returns or settled an IRS audit? Businesses should make sure state amended returns are filed on a timely basis to report the federal changes. If a federal amended return is filed, amended state returns may still be required even when there is no change to state taxable income or deductions.

STATE PASS-THROUGH ENTITY ELECTIONS

The TCJA introduced a \$10,000 limit for individuals with respect to federal itemized deductions for state and local taxes paid during the year (\$5,000 for married individuals filing separately). Nearly 30 states have enacted workarounds to this deduction limitation for owners of pass-through entities, by allowing a pass-through entity to make an election (PTE tax election) to be taxed at the entity level. PTE tax elections present complex state and federal tax issues for partners and shareholders. Before making an election, care needs to be exercised to avoid state tax traps, especially for nonresident owners, that could exceed any federal tax savings.

OTHER STATE AND LOCAL TAXES

State and local property taxes, sales and use taxes and other indirect state and local taxes can be the largest piece of an organization's state tax expenditures, even exceeding state and local income and franchise taxes. Just like state income taxes, businesses should understand and plan for their other state and local tax obligations. Some areas of consideration include:

- Has the business reviewed its sales and use tax nexus footprint, the taxability of its products and services, and whether it is charging the appropriate sales and use tax rates? A comprehensive review of the sales and use tax function along with improving or automating processes may help businesses report and pay the appropriate amount of tax to the correct states and localities.
- Remote retailers, marketplace sellers and marketplace facilitators (i.e., marketplace providers) should be sure they are in compliance with state sales and use tax laws and marketplace facilitator rules.
- Assessed property tax values typically lag behind market values. Businesses should consider challenging their property tax assessments within the applicable appeal window.
- Businesses should ensure they are properly reporting and remitting unclaimed property to state governments. All 50 states and the District of Columbia require holders to file unclaimed property returns.



ACCOUNTING FOR INCOME TAXES

ASC 740 CONSIDERATIONS

The financial year-end close can present unique and challenging issues for tax departments. To avoid surprises, tax professionals can begin now to:

- Evaluate the effectiveness of year-end tax accounting close processes and consider modifications to processes that are not effective. Update work programs and train personnel, making sure all team members understand roles, responsibilities, deliverables and expected timing. Communication is especially critical in a virtual close.
- Consider the tax accounting impacts of enacted legislation in 2022. The accounting for tax credits enacted as part of the CHIPS Act and the IRA can be challenging.
- Stay abreast of pending tax legislation and be prepared to account for the tax effects of legislation that is enacted into law before year end. Whether legislation is considered enacted for purposes of ASC 740 depends on the legislative process in the particular jurisdiction.
- Document whether and to what extent a valuation allowance should be recorded against deferred tax assets in accordance with ASC 740. Depending on the company's situation, this process can be complex and time consuming and may require scheduling deferred tax assets and liabilities, preparing estimates of future taxable income and evaluating available tax planning strategies.
- Determine and document the tax accounting effects of business combinations, dispositions and other non-recurring transactions.
- Review the intra-period tax allocation rules to ensure that income tax expense/(benefit) is correctly recorded in the financial statements. Depending on a company's transactions, income tax expense/(benefit) could be recorded in continuing operations, discontinued operations or equity.
- Evaluate existing and new uncertain tax positions and update supporting documentation.
- Ensure tax account reconciliations are performed and provide sufficient detail to validate the year-over-year change in tax account balances.
- Understand required tax footnote disclosures and build the preparation of supporting documentation into the year-end close process.



BEGIN PLANNING FOR THE FUTURE

Businesses should consider actions that will put them on the best path forward for 2022 and beyond. Business can begin now to:

- Establish or build upon a framework for total tax transparency to bring visibility to the company's approach to tax and total tax contribution.
- Reevaluate choice of entity decisions while considering alternative legal entity structures to minimize total tax liability and enterprise risk.
- Evaluate global value chain and cross-border transactions to optimize transfer pricing and minimize global tax liabilities.
- Review available tax credits and incentives for relevancy to leverage within applicable business lines.
- Consider legal entity rationalization, which can reduce administrative costs and provide other benefits and efficiencies.
- Consider the benefits of an ESOP as an exit or liquidity strategy, which can provide tax benefits for both owners and the company.
- Perform a cost segregation study with respect to investments in buildings or renovation of real property to accelerate taxable deductions, claim qualifying bonus depreciation and identify other discretionary incentives to reduce or defer various taxes.
- Evaluate possible co-sourcing or outsourcing arrangements to assist with priority projects as part of an overall tax function transformation.

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Please contact us if you have questions about the contents of this letter or would like to further discuss your year-end tax planning options.

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