ECONOMY, ELECTION AND YEAR-END PLANNING
THE PERFECT STORM FOR BUSINESSES

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With You Today

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THE PERFECT STORM FOR BUSINESSES
Introduction
Introduction

- As the end of the year approaches, now is a good time to consider planning moves that will help lower your tax bill for this year and possibly next year.
- Year-end planning for 2020 continues to take place against the backdrop of new tax laws that make major changes to the rules for individuals and businesses, as well as the presidential election.
- As we head toward year-end, there are many tried and true tax planning strategies that should be considered, bearing in mind how past, current and future tax laws will impact you and your business.
- Today we will look at some of the more common year-end planning considerations and how potential tax law changes might impact your decisions, depending in large part on your expected marginal income tax bracket in 2021 relative to the current year.
To provide sufficient background as to where we are today before going into possible changes as a result of the presidential election, we will revisit at a very high level, the changes that have been implemented since the Obama administration. We will begin by covering some of the most prominent tax law changes leading up to today, including the TCJA, which was passed by Congress and signed into law on Dec. 22, 2017, before reviewing the updates from the CARES Act, which was passed by Congress and signed into law on Mar. 27, 2020.

As you will soon see, the TCJA brought about significant tax savings for individuals owning flow-through entities, as well as for C corporations, and the CARES Act had numerous provisions that helped to stimulate the businesses that were suffering as a result of the coronavirus pandemic. While future changes could be on the horizon, if no new laws are passed, many of the tax reform changes from the TCJA are considered temporary, with the new law generally becoming effective on Jan. 1, 2018, and expiring on Dec. 31, 2025.
Current Tax Landscape
Legislative and Regulatory Changes to Consider for 2020

Corporate Income Tax Rate Reduction and Abolition of AMT for Corporations

- The TCJA lowered the corporate income tax rate from a high of 35% to a flat rate of 21%.
- The TCJA repealed the AMT for corporations but allows the refund of corporate AMT credits over a four-year period from tax years beginning in 2018 through 2021. The AMT credit is refundable for any taxable year beginning after 2017 and before 2022 in an amount equal to 50% (100% for taxable years beginning in 2021) of the excess credit for the taxable year.
- The CARES Act accelerated the period in which the credit will be refunded. Corporations can claim 100% of AMT credits in 2019 as fully refundable on 2019 returns.
- An alternative was provided for taxpayers to make an election to accelerate the alternative minimum tax (AMT) refund to 2018.
Legislative and Regulatory Changes to Consider for 2020

Changes to Rules Governing Pass-through Entities

► The TCJA made numerous changes that affect business owners of pass-through entities.

► Individual income tax rates were reduced across the seven brackets with rates starting at 10% and reaching as high as 37%.

► For non-corporate taxpayers with qualified business income (QBI) from a pass-through entity (e.g., partnership or S corporation), there is a new Section 199A QBI deduction of up to 20%, which reduces the highest effective tax rate for individuals with QBI from 37% to as low as 29.6%.

► QBI includes the net amount of domestic qualified items of income, gain, deduction and loss with respect to the taxpayer’s qualified business. The deduction may be limited in certain circumstances.
Changes to Rules Governing Pass-through Entities

- The CARES Act retroactively turned off the excess business loss limitation rule that applies to non-corporate owners of pass-through businesses by delaying its effective date from 2018 to post-2020 tax years.

- An excess business loss for the tax year is the excess of aggregate deductions of the taxpayer attributable to trades and businesses over the sum of aggregate gross income or gain of the taxpayer. It is limited to losses exceeding $500,000 for married individuals filing jointly ($518,000 for 2020) and $250,000 for other individuals ($259,000 for 2020).

- An additional Medicare tax of .9% is imposed on earned income for married taxpayers making more than $250,000 and $200,000 for those who are not married at year-end.

- Active partners in partnerships are subject to the Medicare tax (passive partners are subject to the net investment income tax).
Legislative and Regulatory Changes to Consider for 2020

Depreciation

- The TCJA expanded bonus depreciation by allowing 100% expensing for the cost of qualified property acquired and placed in service after Sept. 27, 2017.

- Bonus depreciation allows taxpayers to claim additional first-year depreciation for newly acquired and certain used property acquisitions with a modified accelerated cost recovery system (MACRS) life of 20 years or less without any proration of the benefit even if the asset is placed in service right before the end of the year.

- The depreciation amount will be gradually reduced for property placed in service after Dec. 31, 2022, and before Jan. 1, 2027, and will fully phase out for property placed in service after Dec. 31, 2026.
The CARES Act adopted the much-needed technical correction to QIP to change the recovery period from 39 years to 15 years. Since the 15-year recovery period is less than the 20-year maximum recovery period for bonus depreciation, QIP property now qualifies for bonus depreciation.

Depreciation

- The TCJA eliminated Qualified Leasehold Improvement property, Qualified Restaurant Property and Qualified Retail Improvement Property classifications and combined them into a single Qualified Improvement Property (QIP) designation for property placed in service after Dec. 31, 2017.

- Qualified improvements include roofs, heating, HVAC, fire protection systems and security systems.

- This property classification was inadvertently classified as 39-year property ineligible for bonus depreciation, which had many retailers and restaurant owners very upset.
Legislative and Regulatory Changes to Consider for 2020

Section 179 Expensing

- The TCJA allows business taxpayers to elect to expense the cost of qualifying property, up to an annual limit of $1 million ($1,040,000 in 2020).
- The limit is reduced by the amount by which the cost of property placed in service during the taxable year exceeded $2.5 million ($2,590,000 in 2020).
- Section 179 provides more flexibility because the expensing election is made on an asset-by-asset basis, whereas bonus depreciation is taken on a class-by-class basis.
- However, since Section 179 has a taxable income requirement, bonus depreciation is often preferable in order to create or increase net operating losses (NOLs).

Taxpayers with expiring NOLs, charitable contribution carryforwards or credit carryforwards should consider electing out of bonus depreciation and not electing Section 179 expensing provisions.
Legislative and Regulatory Changes to Consider for 2020

Net Operating Losses

- Pre-TCJA NOLs had a carryback period of two years and a carryforward period of 20 years and are not subject to the 80% of taxable income limitation.
- The TCJA limits NOL carryforwards to 80% of taxable income for tax years beginning after Dec. 31, 2017.
- The TCJA also eliminated the carryback of NOLs but allowed unused NOLs to be carried forward indefinitely, before subsequently being modified by the CARES Act.
- The CARES Act temporarily relaxes the NOL rules by allowing taxpayers that incur NOLs arising in 2018, 2019 or 2020 to carry back such losses five years.

The CARES Act also removed the taxable income limit so that an NOL can fully offset taxable income to generate the maximum cash refund. For tax years beginning after 2021, taxpayers will be eligible for: (1) a 100% deduction of NOLs arising in tax years before 2018 and (2) a deduction limited to 80% of taxable income for NOLs arising in tax years after 2017.
Legislative and Regulatory Changes to Consider for 2020

Business Interest Expense Deduction

► The TCJA replaced the old Section 163(j), which disallowed the deduction of interest expense for thinly capitalized C corporations, with a new rule that applies to all business-related debt and all taxpayers, regardless of the taxpayer’s choice of entity.

► The new Section 163(j) limit is calculated as the sum of a taxpayer’s business interest income, 30% of adjusted taxable income (ATI) and floor plan financing interest expense for the taxable year.

► ATI is essentially taxable income as adjusted for items such as business interest income or expense, NOLs, 199A adjustments, and depreciation, amortization and depletion for tax years beginning before Jan. 1, 2022.
Business Interest Expense Deduction

► The CARES Act temporarily increases the ATI deduction limitation from 30% to 50% for 2019 and 2020 (except for partnerships), which should increase interest deductions and related NOL and refund opportunities.

► For partnerships, the 30% of ATI limit remains in place for 2019 but conforms to the 50% limitation for 2020, with transitional rules to effectively give partners an increased limitation for the 2019 business interest of a partnership.

► Final regulations were issued this year that narrow the definition of what constitutes interest for purposes of the limitation. Items such as debt issuance costs, loan commitment fees, certain hedging income, and guaranteed payments for the use of capital can now be excluded from the definition of interest subject to the Section 163(j) rules.

Another welcome change for manufacturers and other taxpayers subject to UNICAP is that large amounts of capitalization under Section 263A will no longer result in a reduction of their business interest expense as capitalized depreciation is now considered an addback for ATI purposes.
Legislative and Regulatory Changes to Consider for 2020

Social Security Tax Deferral and Refundable Payroll Tax Credit

- The CARES Act permits employers to defer paying the employer portion of certain payroll taxes through the end of 2020, with the deferred amount due in two equal installments, one by Dec. 31, 2021 and the other by Dec. 31, 2022.
- Tax payments that can be deferred generally include the 6.2% employer portion of the social security taxes.
- Taxpayers with small business loan debt forgiven under the PPP program are not eligible for deferral.
- A refundable payroll tax credit is available to an employer that suffered harm by the pandemic but retained its employees. The credit is equal to 50% of qualified wages paid to employees between Mar. 12, 2020 and Dec. 31, 2020 and is capped at $10,000 of wages per employee, or $5,000 per employee (50% of $10,000).
- The credit is available regardless of the size of the workforce, although special rules apply to limit availability to certain employees of larger employers.
Legislative and Regulatory Changes to Consider for 2020

Qualified Opportunity Zones (QOZ)

- Incentives introduced by the TCJA to encourage investment in businesses operating in certain low-income, distressed communities in all 50 states.
- Qualifying investments are granted a temporary deferral or a permanent exclusion from gross income for reinvestment of capital gains into a QOZ within six months of a disposal.
- Specific rules apply as to which gains qualify for the incentives.
- More than 8,700 communities in all 50 states, the district of Columbia and the five U.S. territories were designated as QOZ (a complete of QOZ can be found in IRS Notices 2018-48 and 2019-42).
Legislative and Regulatory Changes to Consider for 2020

QUALIFIED OPPORTUNITY ZONES (QOZ)

Tax benefits offered to those that reinvest in QOZs include the following:

- Tax deferral on capital gain invested in a QOZ Fund to the earlier of the sale from the QOZ Fund or Dec. 31, 2026.
- 10% tax reduction if fund is held for 5+ years and 15% reduction if held for 7+ years.
- Tax exemption if held for 10+ years on appreciation of QOZ Fund investment, which is not the original gain but the post-acquisition gain.
- Under the permanent exclusion, any post-acquisition capital gains on investments in QOZ Funds that are held for at least 10 years are excluded from gross income.
- Rules exist that allow for a step-up in basis for an investment in a QOZ Fund that was held for 10 years or more.
Impact of Election on Future Tax Law Changes and Year-End Strategies
Potential Future Legislation

The following areas of tax law should be considered with respect to future legislation:

- Ordinary Income Tax Rates
- Capital Gains and Qualified Dividend Income
- Effective Tax Rate on Flow-Through Entities
- Effective Tax Rate on Corporations
- Future Changes to Social Security and Medicare Taxes
- Estate Tax Planning for Transfers of Closely-Held Business Interests
- Other Investment, Manufacturing and Business Incentives
Year-End Tax Planning Considerations
Common Year-End Tax Planning Strategies

- Effective year-end tax planning considers each taxpayer’s unique situation and tax planning goals.
- Tax strategy when taxable income and rates remain consistent from year to year.
- Tax strategy when taxable income and rates are expected to increase:
  1. Income deferral strategies
  2. Deduction acceleration strategies
  3. Expensing of capital assets (e.g., placing PP&E into service by Dec. 31, 2020)
  4. Closing on taxable asset acquisitions before Dec. 31, 2020
Reverse Tax Planning Strategies

Taxpayers should reverse traditional tax planning strategies if they expect to be in a higher income tax bracket in the following year. Common reverse tax planning strategies include:

1. Income acceleration strategies
2. Deduction deferral strategies
3. Capitalization of assets
4. Placing assets in service after Dec. 31, 2020
5. Closing on taxable acquisitions after Dec 31, 2020
ACCELERATED AMT REFUND OPPORTUNITY
Under the TCJA, the corporate AMT credit could be fully utilized against regular income tax, but the unused amount was refundable for the four-year period 2018-2022 in an amount equal to 50% of the balance, with any remaining credits fully refundable in 2021. Under the CARES Act, a corporation can elect to take the entire refundable AMT credit in 2018, rather than claim the remaining half of the credit in 2019. Taxpayers that have not already taken advantage of receiving cash for any outstanding tax credits should do so immediately.

BONUS DEPRECIATION VS. SECTION 179 EXPENSING
Determine whether it is more beneficial to take bonus depreciation or Section 179 expensing, although, because Section 179 has a taxable income requirement, bonus depreciation is often preferable to create or increase NOLs. Also, consider timing with respect to when acquired property should be placed in service to obtain the write-off in the highest marginal tax rate year.

Examples of Areas to Benefit from Recent Legislative Changes
NOL Utilization: The CARES Act provisions provide an opportunity for taxpayers to improve their cash positions by taking advantage of the temporary NOL carryback relief provisions.

- The carryback of NOLs to years before 2018 (potentially to as early as 2013) can produce considerable federal income tax benefits because the pre-TCJA tax rate was as high as 35% for corporations (and 39.6% for non-corporate taxpayers), versus current rates as low as 21% for corporations and 29.6% for QBI of individuals.

- Companies should accelerate deductions into the current year and defer income where possible to maximize NOL carryback and refund potential (e.g., consider techniques that accelerate deductions and defer income, and consider the timing with respect to reducing expenditures related to certain PPP loans greater than $2 million).

- Non-corporate owners of pass-through businesses should consider the change to the effective date of the excess business loss limitation rule and undertake careful planning by year-end, which may include infusing capital into loss companies to create basis before year-end or performing increased activities in the pass-through entity.
Examples of Areas to Benefit from Recent Legislative Changes

**Relaxation of business interest expense deduction restriction**
- The CARES Act increase in the ATI limitation from 30% to 50% allows taxpayers to deduct more business interest expense in 2019 and 2020.
- Review sources of interest expense to see if they can be excepted from the narrower definition of business interest in the final regulations. Consider current adjustments as well as amending earlier returns.

**Employer payroll tax deferral and payroll tax credit**
- Consider eligibility for any of these benefits to provide for both temporary and permanent cash flow benefits that will help businesses to survive the cash crunch caused by the pandemic.

**Consider applying for the medical leave tax credit**
- This credit is available to certain employers on up to 25% of wages paid to employees who are allowed time off due to the birth of children or to care for family member with a serious health condition.
Advanced Year-End Tax Planning Considerations for Businesses
Other Tax Planning Options for Businesses

R&D Tax Credit

- An income tax credit is equal to 20% of the excess of qualified research expenditures (QREs; in-house and contract research expenditures such as wages and supplies) for the taxable year over the base amount. A reduced credit could be taken to preserve otherwise disallowed expenditures.

Section 199A

- Taxpayers may also be able to increase the Section 199A deduction by increasing W-2 wages before year-end.

Bonus Planning

- Tax planning is available to secure deductions for accrual and cash basis taxpayers before year-end.
Other Tax Planning Options for Businesses

S Corporation Planning

- Planning includes timing of income recognition and consideration of passive activity loss and basis rules to allow for losses in the current year.

Partnership Losses

- A partner’s share of partnership losses is deductible only to the extent of his or her partnership basis as of the end of the partnership year in which the loss occurs. The amount of this basis can be increased by a capital contribution and increases in the partner’s share of partnership liabilities. However, decreases in a partner’s share of partnership liabilities will reduce basis.
Other Tax Planning Options for Businesses

Timing Distributions of Appreciated Property
- Delaying a distribution of appreciated property or a corporate liquidation by a day can defer taxes for an entire year.

Closely-held Businesses
- Consider estate planning with respect to gifts of business interests before year-end.

Increase Business Interest Deductions
- Consider whether any businesses are excepted trades or businesses and taking advantage of the many benefits within the CARES Act and the final and new proposed regulations on business interest.

Section 382 Studies
- Certain techniques are employed to increase the annual limitation otherwise applied to limit NOL usage.
Other Tax Planning Options for Businesses

Entity Simplification or Restructuring
- Increase tax basis for loss utilization and tax-free distributions and allow for additional interest expense by combining income in a closely-held context. It could also result in a worthless stock deduction in a consolidated return context.

Transaction Cost Analysis
- Millions of dollars of otherwise capitalized and non-deductible losses could be freed up.

Qualified Small Business Stock
- Eligible taxpayers that qualify could exclude gains of up to $10 million or 10 times their tax basis for stock that has been held for five years and that otherwise meets all of the corporate qualification requirements.

IRS Account and Interest Recovery Services
- Consider undertaking a project to identify IRS errors in processing and posting payments and to recover misapplied payments and interest.
International Tax Considerations
International Tax Considerations (Outbound)

Application of the CFC Anti-deferral Rules Including:

- GILTI high-tax election
  - Modeling to determine the implications of making election
- Section 250 GILTI deduction, where applicable
- Various exceptions/special rules relating to subpart F income/tested income and tested loss and rules coordinating the subpart F and GILTI regimes
- For domestic partnerships that own controlled foreign corporations (CFCs), the GILTI final regulations provide that the Section 951A tested items are taken into account by “U.S. shareholder” partners; domestic partnerships do not calculate a GILTI amount
  - However, domestic partnerships are treated as “U.S. shareholders” for purposes of determining CFC status and can be controlling domestic shareholders
  - See Reg. §1.951A-1(e) (and the examples thereunder) for further details
International Tax Considerations (Outbound)

- Under existing final regulations, when a domestic partnership owns CFCs, the domestic partnership that is a “U.S. shareholder” generally includes its pro rata share of subpart F income and such inclusion is allocated to the partners under the partnership rules.
  - Consider whether to rely on and apply (subject to certain requirements being satisfied) the 2019 proposed Section 958 regulations that would determine subpart F inclusions (and Section 951A tested items) at the “U.S. shareholder” partner level, along with the impact of these rules.
    - Note—under these proposed regulations, domestic partnerships are treated as “U.S. shareholders” for purposes of determining CFC status and can be controlling domestic shareholders.
    - See Prop. Reg. §1.958-1(d) (and the examples thereunder) for additional guidance.

- Consider Notice 2020-69 relating to S corporations with certain accumulated earnings and profits.

- Eligibility to claim deemed paid foreign tax credits (FTCs) under Section 960 for subpart F/GILTI inclusions including any FTC limitations (e.g., scale backs/limitations for GILTI FTCs).
International Tax Considerations (Outbound)

Application of Section 163(j) at the CFC Level Including:

- Applicability dates of the various regulations (e.g., final regulations, 2020 proposed regulations, 2018 proposed regulations) and requirements for applying them.

- If applying Prop. Reg. §1.163(j)-7 of the 2020 proposed regulations (including meeting any requirements to apply those regulations), consider:
  - Rules generally apply on a CFC-by-CFC basis
  - If a CFC group exists, consider the CFC group election and possible increase in ATI of the U.S. shareholder for all or a portion of certain deemed CFC inclusions
    - General approach of final and proposed regulations is that CFC deemed inclusions are subtracted out of a U.S. shareholder’s tentative taxable income
  - It is possible for a U.S. shareholder of a stand-alone CFC to increase the U.S. shareholder’s ATI for all or a portion of certain deemed CFC inclusions.
International Tax Considerations (Outbound)

• Consider safe harbor election (but if safe harbor is elected, no increase to U.S. shareholder’s ATI for certain deemed CFC inclusions)
• See Prop. Reg. §1.163(j)-7 for additional details

▶ If taxpayer is an “applicable taxpayer” for BEAT purposes, consider measures that may reduce the BEAT liability including the “BEAT waiver” election under the final regulations and the corresponding implications.

▶ In light of the TCJA’s repeal of Section 958(b)(4), review the overall group structure to identify potential CFCs, Form 5471 filing obligations (and possible exceptions to filings) and subpart F/GILTI inclusions (assuming Section 958(a) ownership).
  • Consider recently issued Treasury guidance relating to the repeal of Section 958(b)(4) (e.g., Rev. Proc. 2019-40, TD 9908, REG-110059-20 and the instructions to Form 5471; see also TD 9883).
  ▶ Consider new expense apportionment rules (R&E, stewardship, etc.) for 2020 FTC provision purposes.
International Tax Considerations (Outbound)

- If a taxpayer is planning to repatriate cash from its CFCs during the current tax year, consider the implications of such repatriations (For example, is the distribution previously taxed earnings and profits (PTEP)? If so, are there any implications (e.g., Section 986(c) exchange gain or loss and corresponding basis reduction)? If the distribution is non-previously taxed E&P, does Section 245A apply? etc.).

- If stock of a CFC is disposed of during the year, depending on the particular facts, several Code provisions and regulations may need to be considered (e.g., if gain is recognized, does Section 1248 (including Sections 1248(c)(2) and (j)) apply? If Section 1248(j) applies, is there a need to consider Section 245A? Is Reg. 1.245A-5 implicated? If there is a loss, can a taxpayer take the loss (e.g., does Section 267(f) apply)?).

- If a taxpayer owns any passive foreign investments companies (PFICs), the taxpayer should consider the PFIC rules.
International Tax Considerations (Outbound)

- If a U.S. C corporation has generated losses through foreign branches or foreign flow-through entities, consider the application of certain rules that may apply.
  - For instance, the dual consolidated loss (DCL) rules under Section 1503(d) and the regulations thereunder and the required filings to be able to take such losses on its U.S. return
  - The impact of such losses on the FTC (e.g., do such losses create an overall foreign loss?)

- If the taxpayer has engaged in an inbound, outbound or foreign-to-foreign restructuring, consider the various cross-border rules in the Code and regulations that may apply.
  - For instance, if the taxpayer made an outbound transfer of assets to a foreign corporation in a non-recognition transaction (such as a Section 351 transfer) during the year, depending on the particular facts, several Code provisions and regulations could apply (Section 367, DCL recapture, overall foreign loss recapture, Section 987 branch termination, etc.)
International Tax Considerations (Outbound)

- Always consider the impact (if any) of any cross-border restructuring during the year on certain agreements the taxpayer may have in place (e.g., the rules relating to gain recognition agreements under Section 367(a), the rules relating to domestic use agreements under the DCL rules and the rules relating to Section 965(h)).

- If CFC stock has become worthless, consider actions that may be taken (e.g., check-the-box election for the CFC) to take such loss in the current year (consider whether the requirements of Section 165, including Section 165(g)(3), have been met).

- If it is anticipated that the U.S. corporate tax rate will be increased for the upcoming year, consider accelerating certain income (e.g., CFC tested income for purposes of the U.S. shareholder’s GILTI inclusion).
Q&A
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