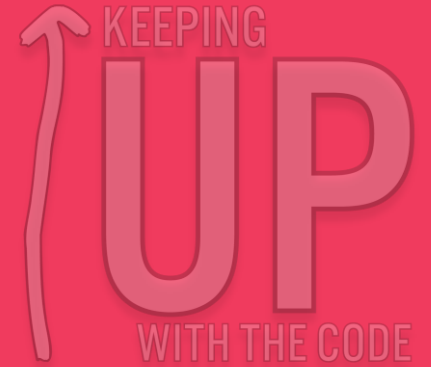


Keeping Up with the Code: 2022 Federal Tax Update

By David R. Peters, CPA, CFP[®], CLU, MBA, MST



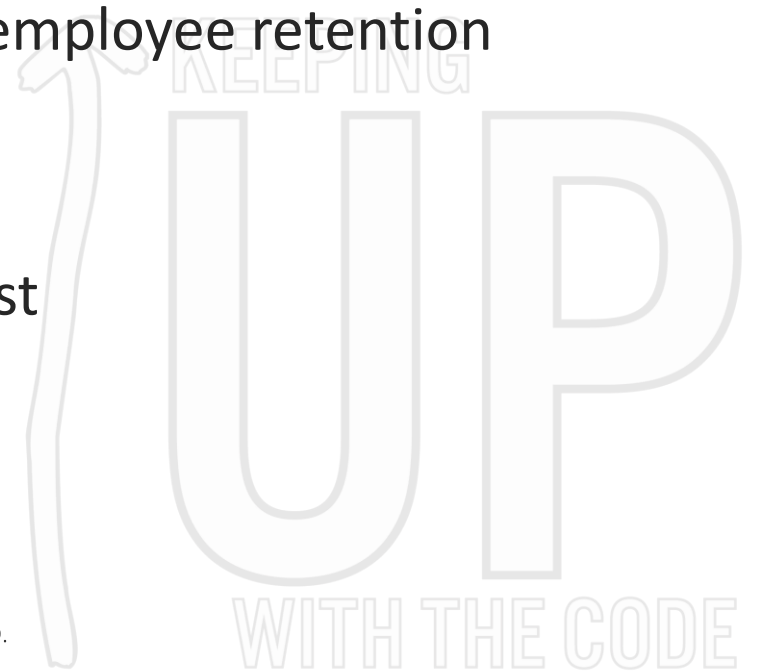
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Learning Objectives

- Identify recent changes in federal tax law
- Recognize the interaction of PPP loan forgiveness and the employee retention credit (ERC).
- Recall the basic tax implications of selling a business interest



I. Recently Passed Legislation

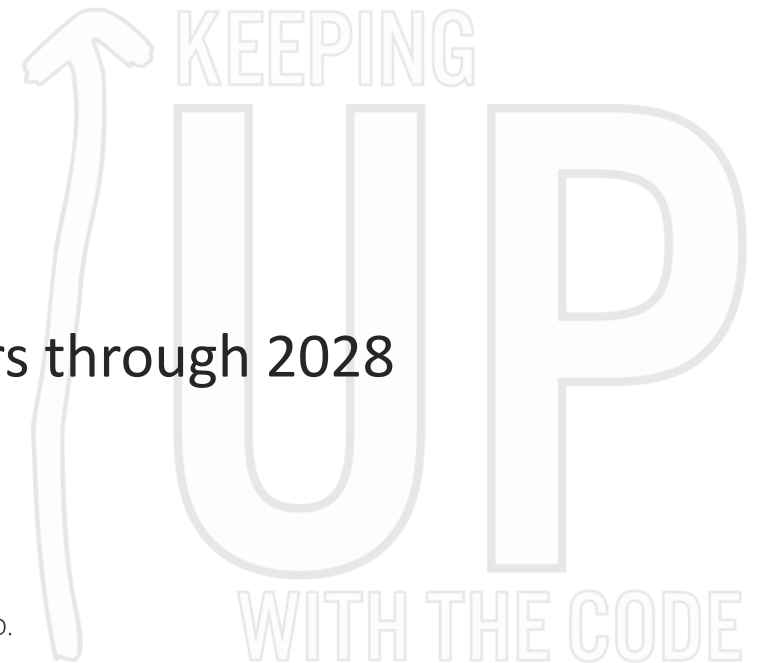


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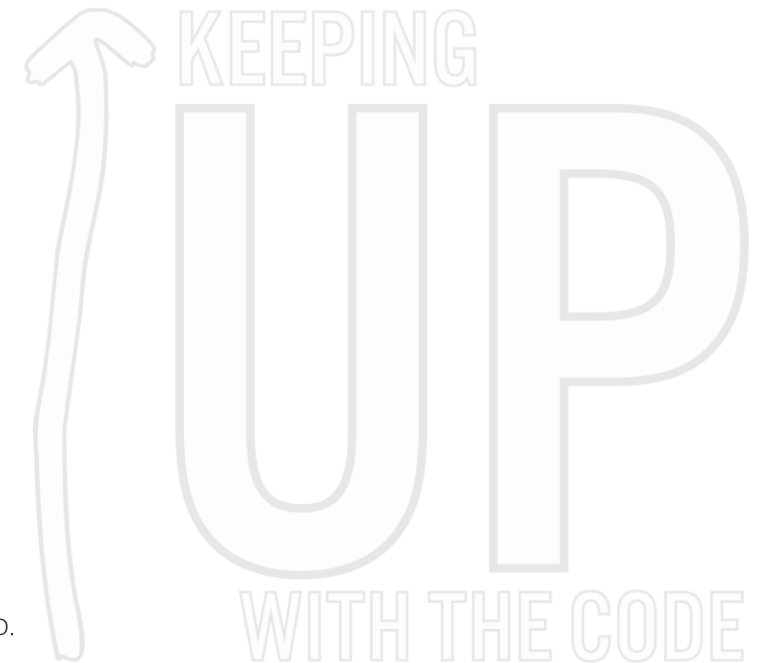
Inflation Reduction Act of 2022

- Signed into law on August 16, 2022
- 15% minimum tax on corporate taxpayers with adjusted financial statement income of \$1 billion or more.
- Tax of 1% on share repurchases.
- Overall Limit on Business Losses for Noncorporate Taxpayers through 2028
**(\$270K S / \$540K MFJ for 2022)



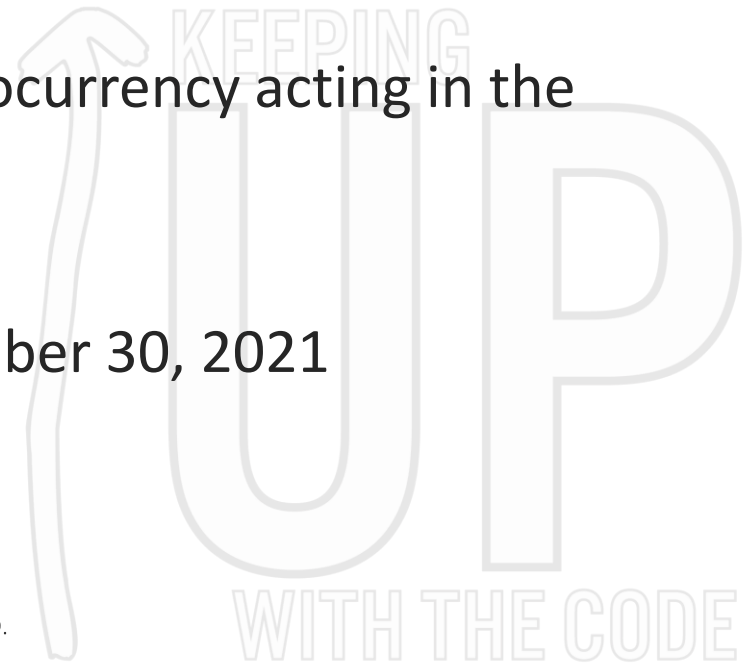
Inflation Reduction Act of 2022

- Expanded version of the premium tax credit is extended through 2025.
 - This provision adjusts the percentage of health care insurance premiums offset by the premium tax credit for certain taxpayers whose household income exceeds 400% of the poverty line (currently applies only to 2021 and 2022)
- Nothing on the SALT Cap!
- Funding for the IRS over the next 10 years:
 - 1) \$45.6 billion for enforcement
 - 2) \$25.3 billion for operations support
 - 3) \$4.75 billion for business systems modernization
 - 4) \$3.18 billion for taxpayer services



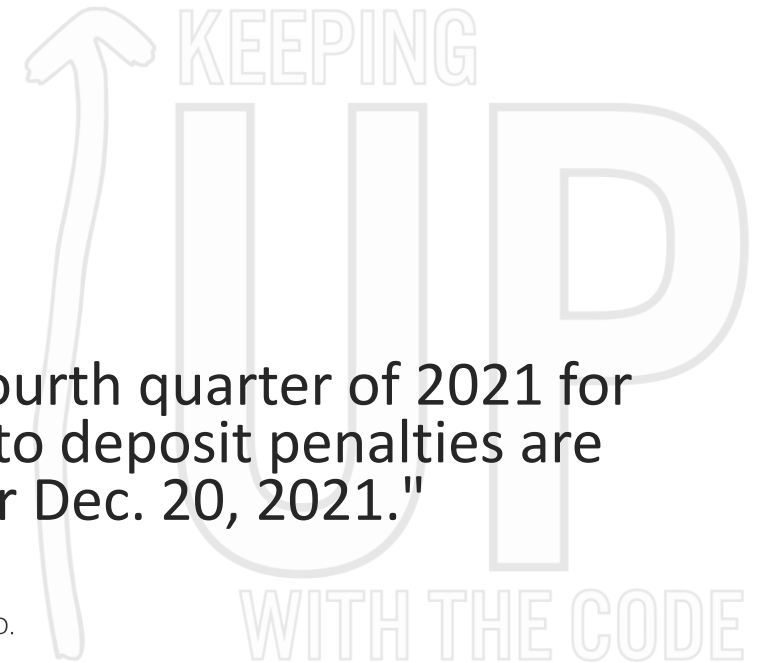
Infrastructure Investment and Jobs Act

- Passed on November 5, 2021 – Mostly concerning spending on infrastructure, but two notable issues in taxation.
- Cryptocurrency – Form 8300 reporting for brokers in cryptocurrency acting in the ordinary course of a trade or business required after 2022
- Employee Retention Credit – Now suspended after September 30, 2021



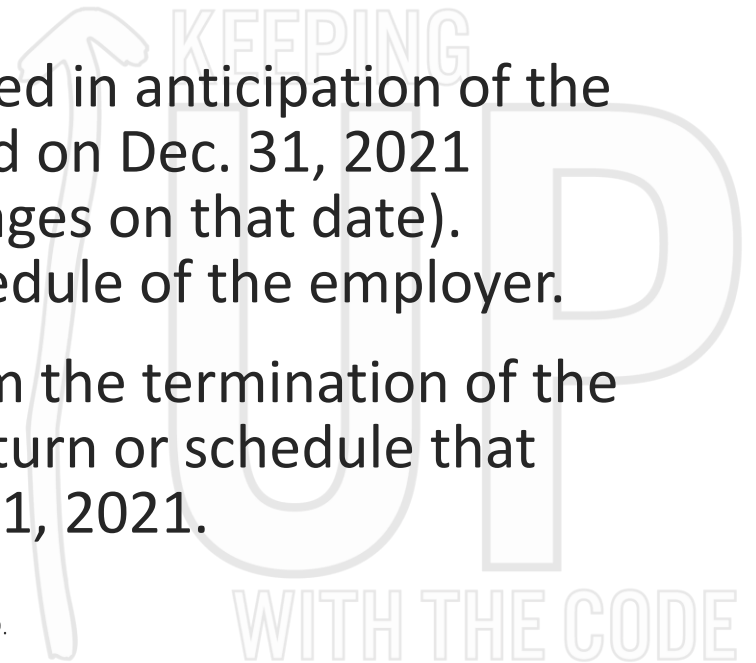
What if you were anticipating a Q4 ERC?

- IRS Notice 2021-65 provides some relief for non-Recovery Start-Up Businesses that anticipated a Q4 2021 ERC.
- No penalties if any advanced payments were repaid by the due date of the employment tax return.
- Penalty relief if taxpayer can show reasonable cause.
- "Due to the termination of the ERC for wages paid in the fourth quarter of 2021 for employers that are not recovery startup businesses, failure to deposit penalties are not waived for these employers if they reduce deposits after Dec. 20, 2021."



What if you were anticipating a Q4 ERC?

- Employers that reduced deposits on or before Dec. 20, 2021, for wages paid during the fourth calendar quarter of 2021 in anticipation of receiving the ERC will not be subject to a failure-to-deposit penalty with respect to the retained deposits if:
 - 1) The employer reduced deposits in anticipation of the ERC consistent with the rules in Notice 2021-24.
 - 2) The employer deposits the amounts initially retained in anticipation of the ERC on or before the relevant due date for wages paid on Dec. 31, 2021 (regardless of whether the employer actually pays wages on that date). Deposit due dates will vary based on the deposit schedule of the employer.
 - 3) The employer reports the tax liability resulting from the termination of the employer's ERC on the applicable employment tax return or schedule that includes the period from Oct. 1, 2021, through Dec. 31, 2021.



II. ERC & Amended Income Tax Returns

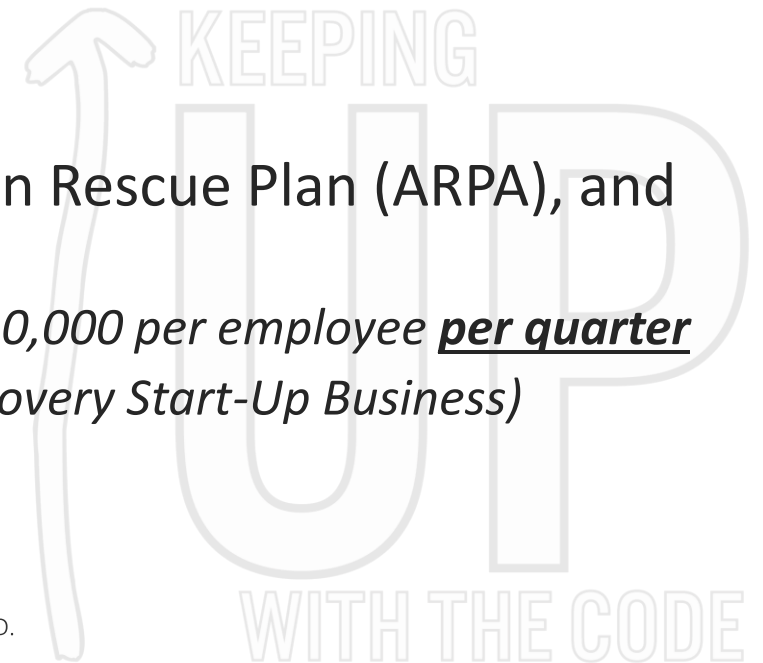


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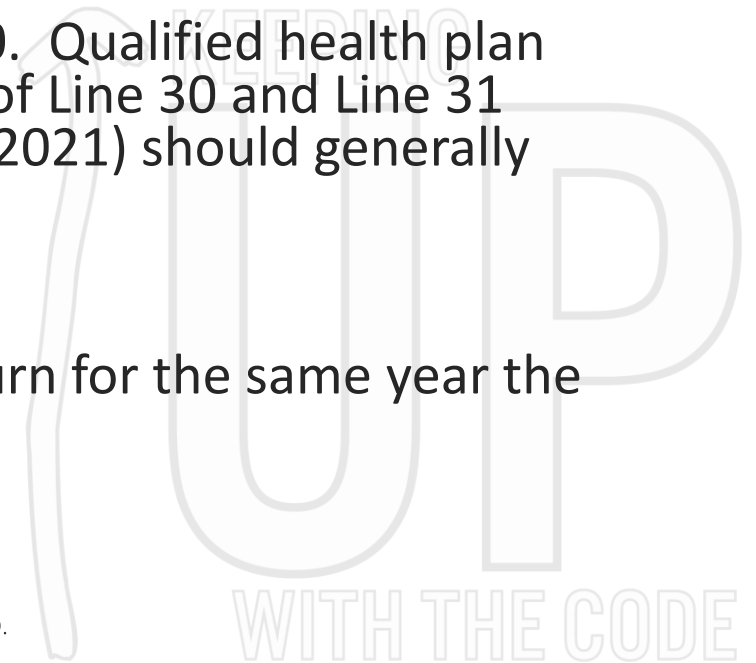
Employee Retention Credit - Expanded

- Under the CARES Act:
 - *Up to 50% of eligible wages paid plus health plan expenses up to \$10,000 per employee*
 - *Eligible period March 13, 2020 to December 31, 2020*
 - *\$5,000 Maximum Credit*
- After the Consolidated Appropriations Act (CAA), American Rescue Plan (ARPA), and the Infrastructure Bill:
 - *Up to 70% of eligible wages paid plus health plan expenses up to \$10,000 per employee per quarter*
 - *Eligible period January 1, 2021 to September 30, 2021 (unless a Recovery Start-Up Business)*
 - *\$7,000 Maximum Credit per quarter*



Amending a 941 to take an ERC

- You generally have 3 years from the date you filed your original return to amend a 941 or 2 years from the date you paid the tax (using Form 941-X).
- Qualified wages for the ERC are reported on Form 941-X, Line 30. Qualified health plan expenses for ERC are reported on Form 941-X, Line 31. The sum of Line 30 and Line 31 multiplied by the credit percentage of either 50% (2020) or 70% (2021) should generally equal the total ERC presented on Lines 18 and 26.
- IRS Notice 2021-49: Employers must amend the income tax return for the same year the credit is taken on the payroll tax return.

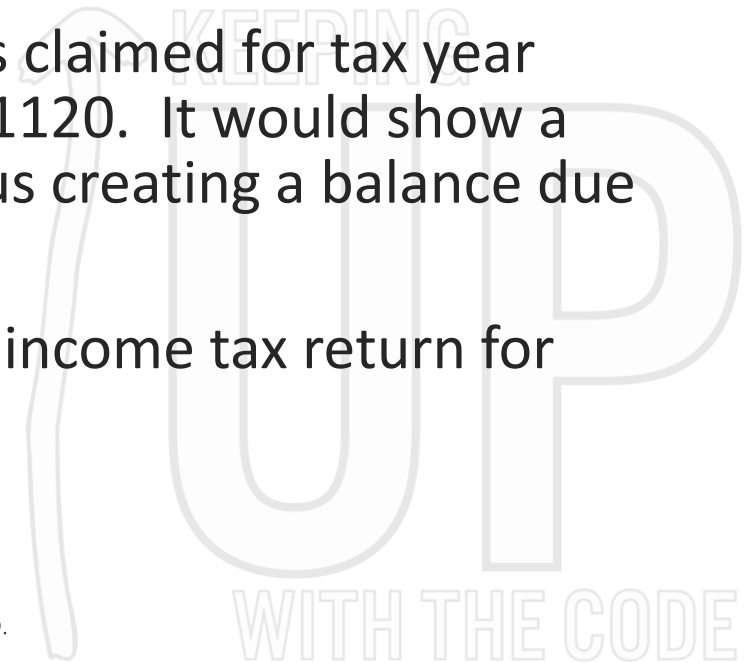


Example 1 – Claiming an ERC for Prior Year

On August 2, 2022, ABC Corporation discovers that it was eligible for an employee retention credit in Q2 2021. The company files a Form 941-X on September 2, 2022 to claim the credit in the amount of \$100,000.

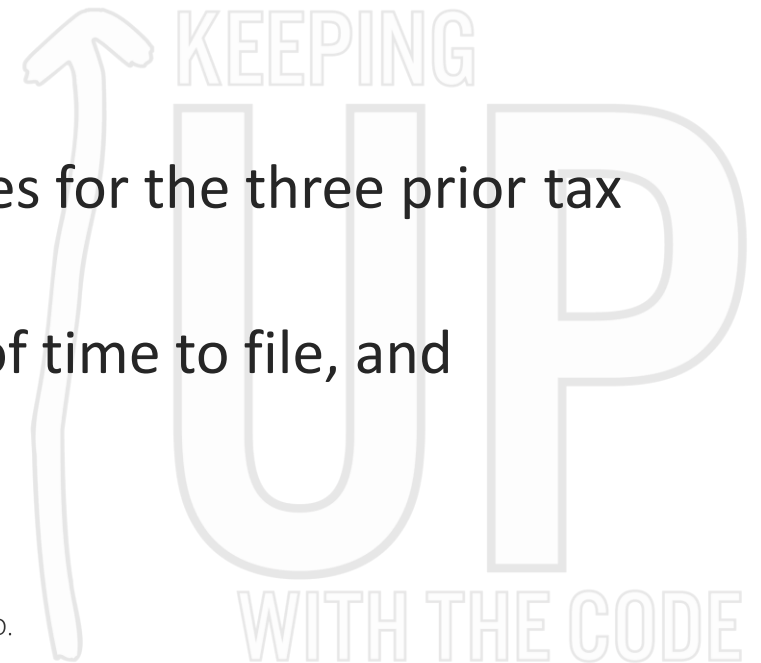
Assume ABC is a calendar year taxpayer. Since the credit was claimed for tax year 2021, ABC Corporation would need to amend its 2021 Form 1120. It would show a wage expense reduction of \$100,000 on its 2021 return – thus creating a balance due on its 2021 income tax return.

In accordance with IRS Notice 2021-49, you must amend the income tax return for the same tax period as the Form 941.



Penalty Relief – IRS Release 4/18/22

- Penalty relief may be available if a taxpayer can show reasonable cause and not willful neglect for the failure to pay.
- IRS First-Time Abatement:
 1. Did not previously have to file a return or had no penalties for the three prior tax years
 2. Filed all currently required returns or filed an extension of time to file, and
 3. Paid, or arranged to pay, any tax due



III. ERC & PPP Loan Forgiveness



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Interaction of ERC & PPP Forgiveness

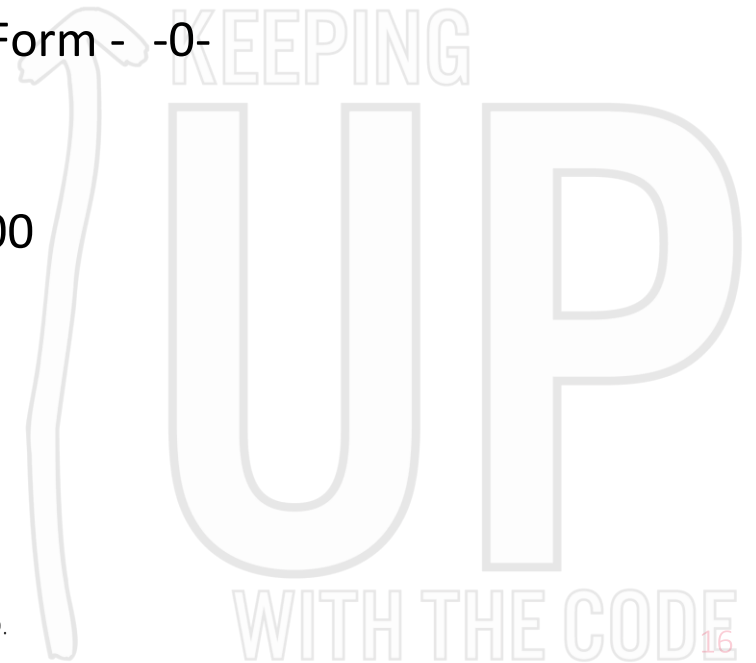
- IRS Notice 2021-20, Q&A 49 says in part *“the amount for which the eligible employer is deemed to have made the election [out of the ERC] is the amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application up to (but not exceeding) the minimum amount of payroll costs, together with any other eligible expenses reported on the PPP Loan Forgiveness Application, sufficient to support the amount of the PPP loan that is forgiven.”*
- Group health benefits, retirement benefits, SUTA taxes, and nonpayroll costs are not taken into account in determining the amount of wages allocable to PPP Loan forgiveness unless reported on the 3508 series forgiveness application

EXAMPLE 2.

FACTS:

- PPP Loan Amount - \$200,000
- ERC Wages Paid 2nd And 3rd Quarter Of 2020 - \$250,000
- ERC Wages Reported On 3508 Series Form - \$250,000
- Other Costs Qualifying For Forgiveness Reported On 3508 Series Form - -0-
- Amount Of PPP Loan Forgiven In 2021 - \$200,000

CONCLUSION: Taxpayer Deemed To Have Elected Out Of ERC For \$200,000 Of Qualifying Wages. \$50,000 Of ERC Wages Qualify For ERC.

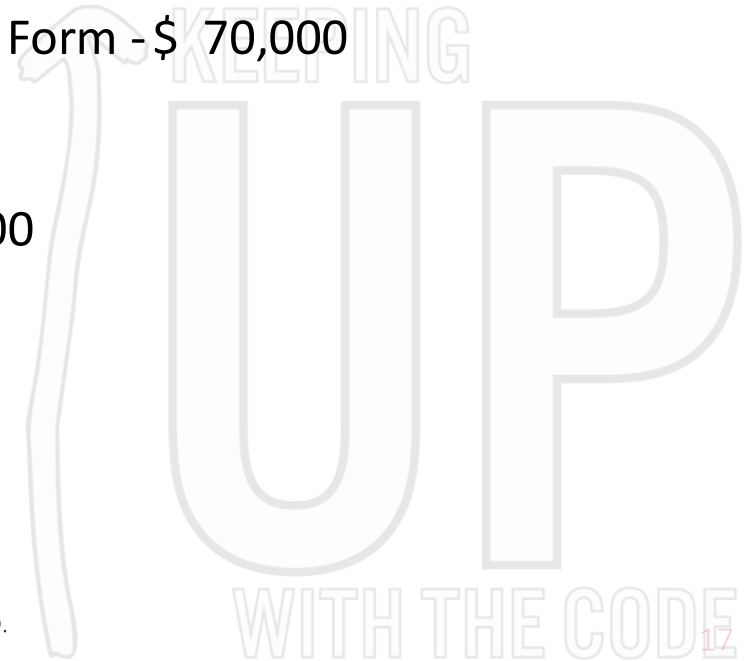


EXAMPLE 3.

FACTS:

- PPP Loan Amount - \$200,000
- ERC Wages Paid 2nd And 3rd Quarter Of 2020 - \$200,000
- ERC Wages Reported On 3508 Series Form - \$200,000
- Other Payroll And Nonpayroll Costs Reported On 3508 Series Form - -0-
- Other Payroll And Nonpayroll Costs Not Reported On 3508 Series Form - \$ 70,000
- Amount Of PPP Loan Forgiven In 2021 - \$200,000

CONCLUSION: Taxpayer Deemed To Have Elected Out Of ERC For \$200,000 Of Qualifying Wages. IRS Says **\$70,000 Of Other Qualifying Costs Are Not Considered Since Not Reported On 3508 Series Form.**

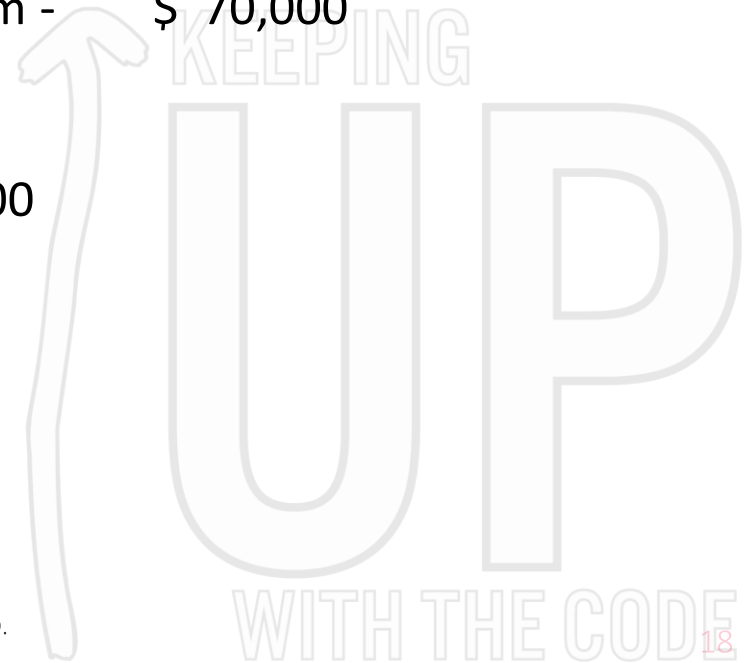


EXAMPLE 4.

FACTS:

- PPP Loan Amount - \$200,000
- ERC Wages Paid 2nd And 3rd Quarter Of 2020 - \$200,000
- ERC Wages Reported On 3508 Series Form - \$200,000
- Other Payroll And Nonpayroll Costs Reported On 3508 Series Form - \$ 70,000
- Amount Of PPP Loan Forgiven In 2021 - \$200,000

CONCLUSION: Taxpayer Deemed To Have Elected Out Of ERC For \$130,000 Of Qualifying Wages. Therefore, \$70,000 Of The ERC Wages Reported On 3508 Series Form Qualify For ERC.



IV. Reminders – Payroll Taxes & Depreciation

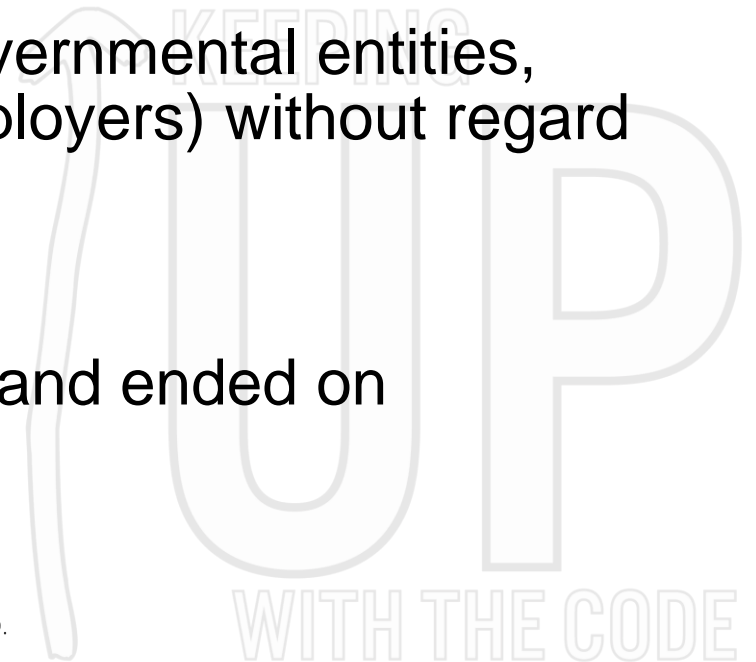


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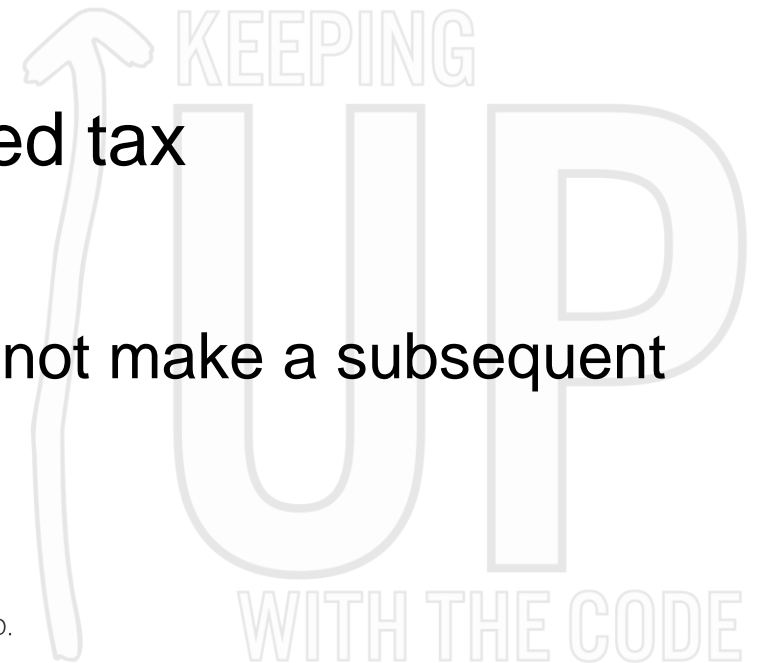
Section 2302 – Employer Portion of Social Security

- Employers had the option to temporarily defer the employer portion of Social Security taxes (6.2% of wages) and certain railroad retirement taxes.
- Generally open to all employers (including governmental entities, self-employed individuals, and household employers) without regard to need.
- Tax deferral period began on March 27, 2020 and ended on December 31, 2020.



Section 2302 – Employer Portion of Social Security

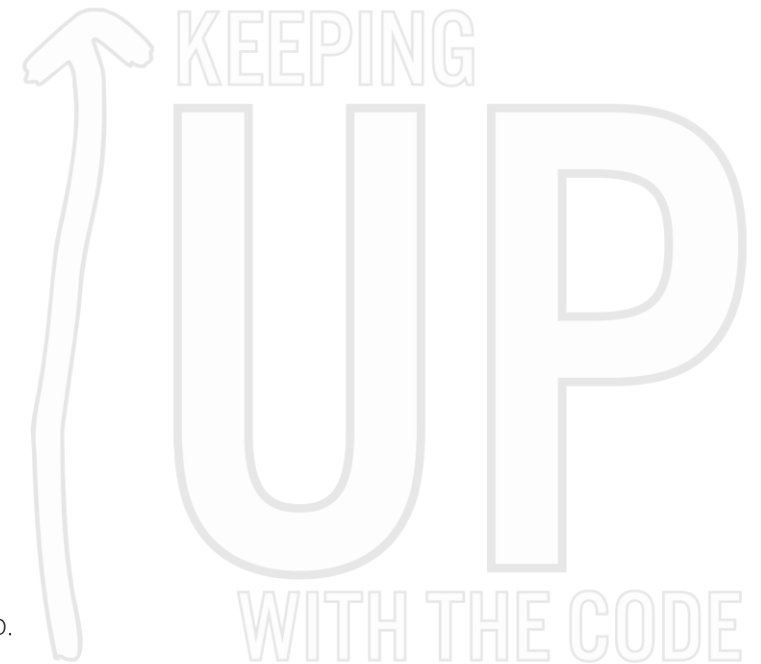
- Deferred employment tax must be paid in 2021 and 2022:
 - 50% due by December 31, 2021; and
 - 50% due by December 31, 2022
- There is no interest charged on the deferred tax
- According to FAQ #9 on IRS.gov: A company cannot make a subsequent decision to defer, if they have already paid.



Depreciation Changes - TCJA

- Bonus depreciation phasing out at the end of 2026:
 - 2023: 80%
 - 2024: 60%
 - 2025: 40%
 - 2026: 20%

As a reminder, ordering rules: 1) 179, 2) Bonus, 3) MACRS



V. Selling a Business Interest

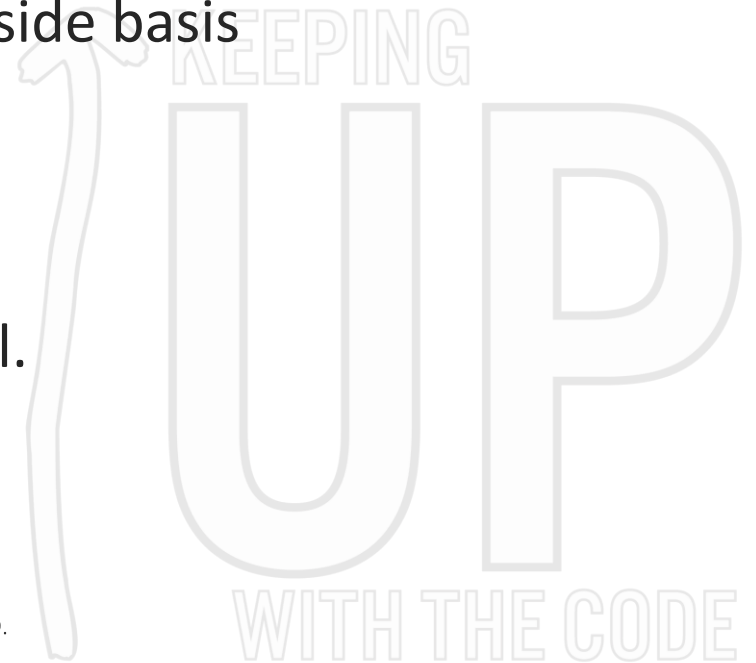


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General Rules for Selling a Business

- Sold business interests generally result in a capital gain or capital loss.
- Basis for determining gain or loss is the equity owner's outside basis
 - ** Partner: Includes Share of Partnership Debt
 - ** S-Corp Shareholder: Does NOT include debt basis
- Relief of Debt is also included in the sales proceeds as well.



Look-Through Provisions

- In the case of a sale of a partnership interest, a partner may have a gain on the sale of a partnership interest reclassified as something other than a 0/15/20% capital gain due to look-through provisions.
- The most notable look-through provisions relate to “hot assets” (IRC 751), which reclassify part of the gain as ordinary to the extent it consists of:
 - Depreciation Recapture
 - Unrealized Receivables (that is, cash basis receivables)
 - Appreciated Inventory
- Look through provisions also apply to Sec 1250 recapture and collectibles gains.



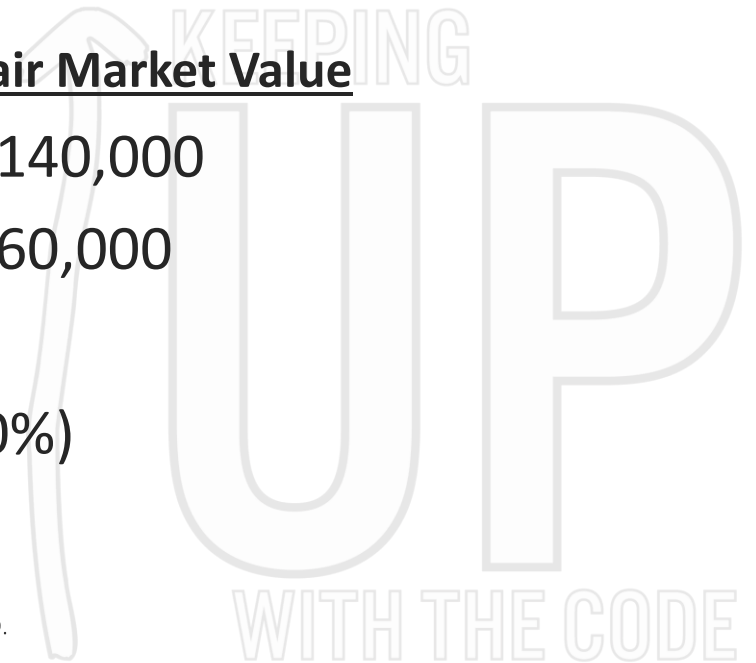
Example 2- Partnership Hot Assets

- Sale of a 50% partnership Interest for \$100,000 (\$55,000 basis).

- Partnership Balance Sheet on the sale date:

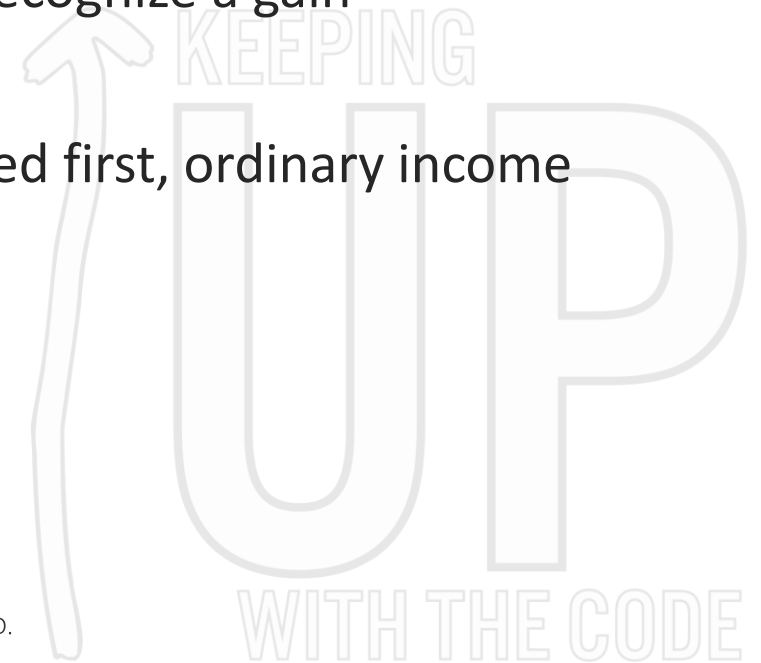
	<u>Basis</u>	<u>Fair Market Value</u>
Inventory	\$60,000	\$140,000
Capital Assets	\$50,000	\$60,000

- Result: \$40,000 ordinary gain, \$5,000 capital gain (0/15/20%)



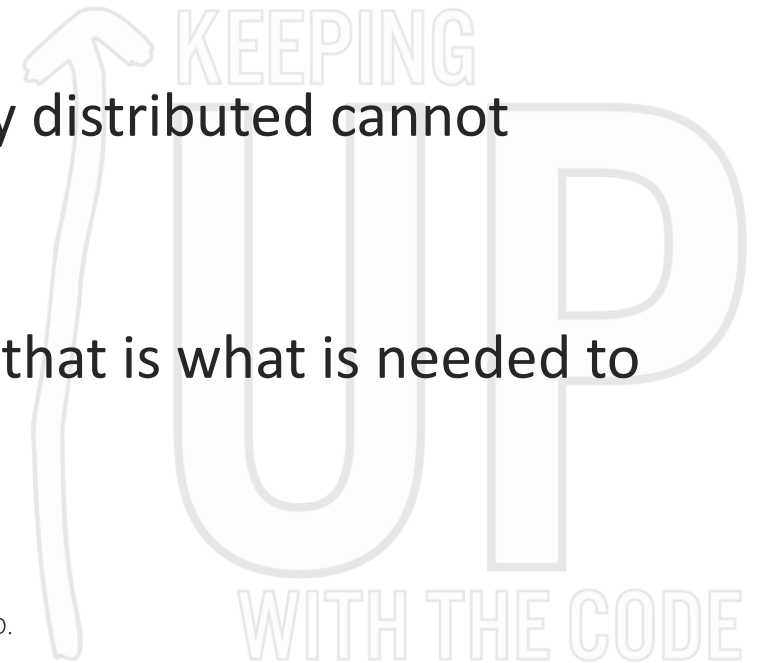
Liquidating Distributions – Partnership

- In the case of a liquidating distribution of a partnership interest:
 - ** If cash distributed is less than outside basis, the partner will recognize a loss
 - ** If cash distributed is more than outside basis, the partner will recognize a gain
- If cash and property are distributed, cash is considered distributed first, ordinary income assets second, and capital gain property last.
- Outside basis must be zero after a liquidating distribution!



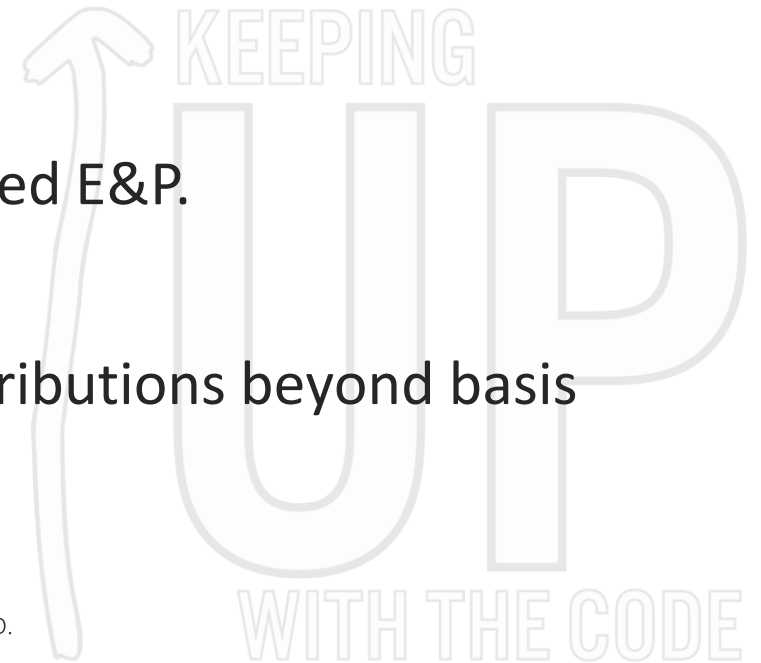
Example 3 – Partnership Liquidating Distribution

- Immediately before the liquidating distribution, the partner's basis is \$100,000. Partner receives cash of \$70,000 and capital gain property (basis: \$20,000, FMV: \$40,000)
- Partner will have no gain or loss, since capital gain property distributed cannot result in a gain or a loss.
- The partner will take a basis in the property of \$30K, since that is what is needed to reduce outside basis to zero. No gain or loss will result.



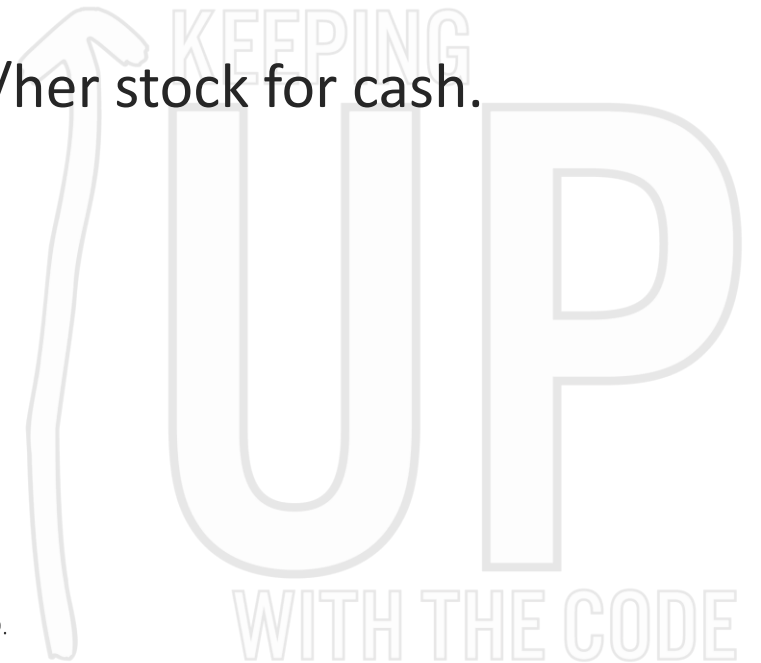
Corporate Distributions in General

- Distributions from a C-Corporation are normally considered to be dividends
 - No deduction to the C-Corporation
 - Taxable Income to the Shareholder
- Distributions come from current E&P first, then Accumulated E&P.
- Distributions greater than E&P are a return of capital. Distributions beyond basis are considered to be a capital gain.



Redemptions – IRC 302(b)

- If a distribution is considered to be a redemption, it is considered to be tax-free to the extent that the shareholder has basis in his/her stock.
- Essentially, you treat it as if the shareholder exchanged his/her stock for cash.



Redemptions – IRC 302(b)

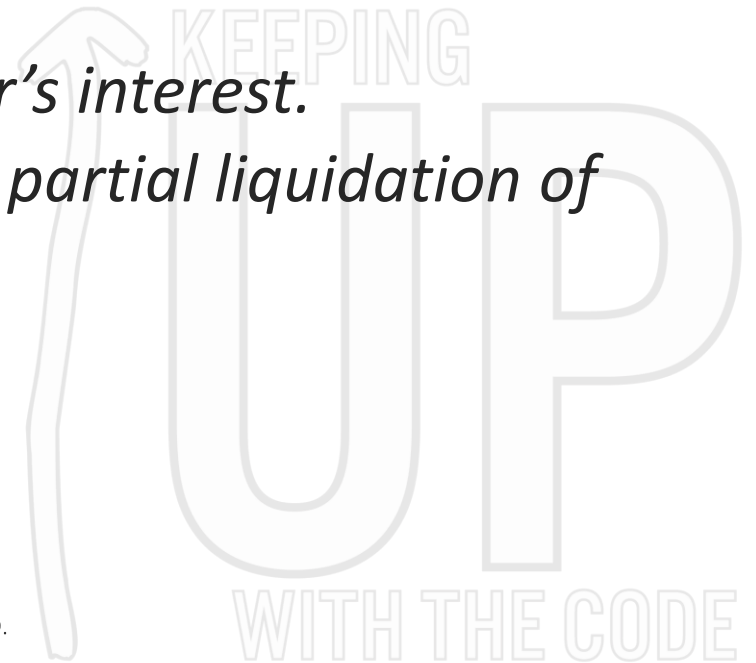
Treated as an exchange under IRC 302, if any of the following apply:

Redemption is not equivalent to a dividend.

Redemption is substantially disproportionate.

Redemption completely terminates the shareholder's interest.

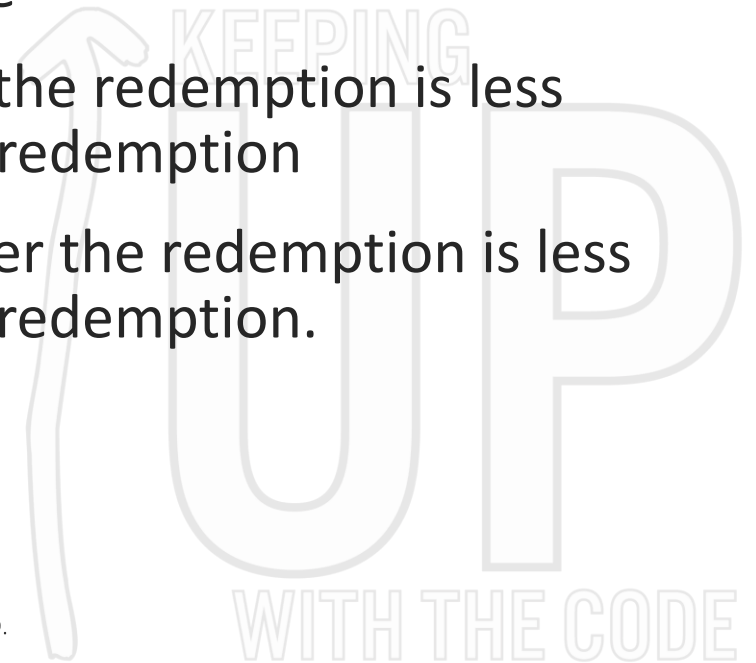
Redemption is from a noncorporate shareholder in partial liquidation of the corporation.



“Substantially Disproportionate” – IRC 302(b)(2)

Must have all three of the following:

- 1) Immediately after the redemption, the s/h owns less than 50% of the total combined voting power of all classes of stock which can vote
- 2) The percentage of voting stock owned immediately after the redemption is less than 80% of the percentage owned immediately before the redemption
- 3) The percentage of common stock owned immediately after the redemption is less than 80% of the percentage owned immediately before the redemption.



Example 4: Substantially Disproportionate

A and B each own 25% (25 shares each) of ABC corporation. ABC redeems 10 shares of A, but only 8 shares of B. Therefore there are 82 shares of ABC owned after the redemption. The ownership shares of A&B are now as follows:

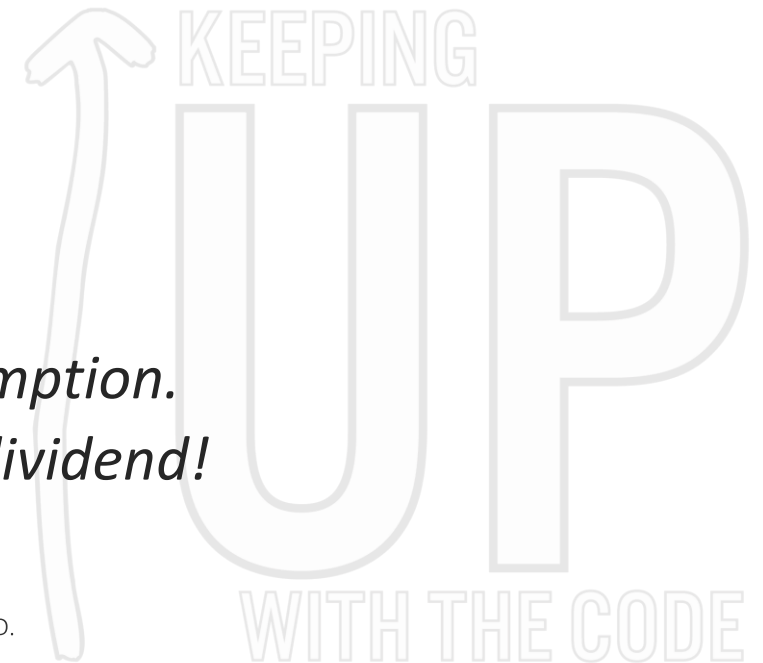
A: 15 shares owned / 82 total shares = 18.29%

B: 17 shares owned / 82 total shares = 20.73%

A has a redemption, but B has a dividend:

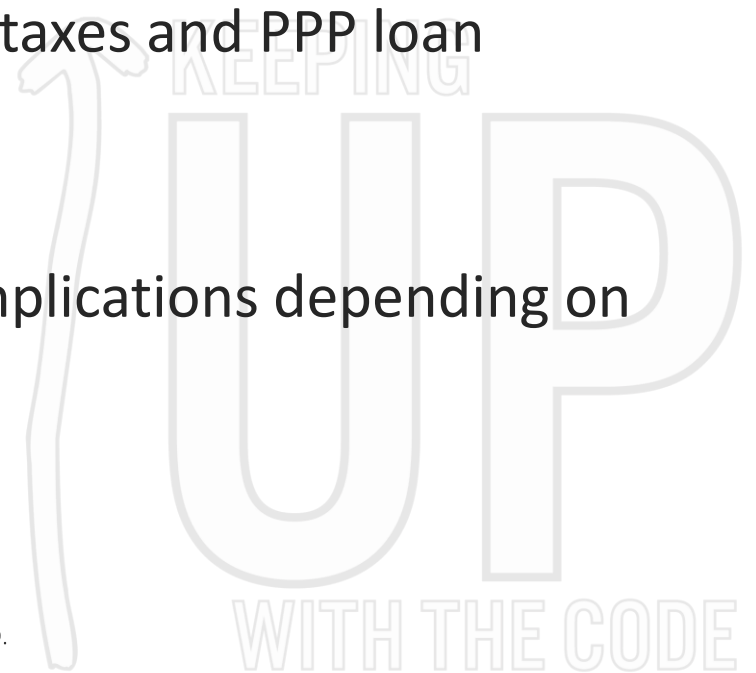
A: $18.29 / 25 = 73.16\%$ → Below 80%, which means redemption.

B: $20.73 / 25 = 82.92\%$ → Not below 80%, which means dividend!



Summing It Up

- In 2022, we are getting clarifications on many tax issues raised in 2020 & 2021.
- Taking the ERC can affect other areas – specifically income taxes and PPP loan forgiveness.
- Selling a business interest can result in very different tax implications depending on your entity type.



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