# Year-End Tax Update and Planning Opportunities

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## *About the Speaker:*

Mike is a Tax Partner in Crowe's National Real Estate & Construction Services Group, which serves over 1,100 industry clients. Mike has more than 20 years of experience focused on strategic federal tax planning, research, and compliance-related services. Mike regularly consults with businesses and owners, including consolidated groups, partnerships, and S-corporations within the following industries: manufacturing, distribution, construction, real estate, and A/E.

# Overview

- Recent tax legislation that may provide current benefits for the business owner
- Latest tax proposals coming out of Washington and update of where they stand
- Key tax planning opportunities businesses and individuals should consider for 2021 and beyond
- International tax update

- Update on Recently Passed Tax Legislature

# Recently Passed Tax Legislature

- Families First Coronavirus Response Act – March 2020
- CARES Act – March 2020
- The Consolidated Appropriations Act – December 2020
- American Rescue Plan Act – March 2021

# Summary of Recently Passed Tax Legislature

- Payroll Tax Deferral
- Paycheck Protection Program
- Employee Retention Credit
- Temporary favorable changes to the Tax Code

# Payroll Tax Deferral

- Employers can defer for up to two years the deposit and payment of their share of the social security tax on employee wages
- Amounts normally due between March 27, 2020 and Dec. 31, 2020, can be deferred with 50 percent required to be paid by Dec. 31, 2021, and the remaining 50 percent by Dec. 31, 2022
- Only applies to employer social security taxes, does not apply to employer Medicare taxes or tax withholdings from employees

# Paycheck Protection Program


- Introduced as an incentive for small businesses to keep their workers on the payroll and maintain operations
- Forgivable loans to qualified employers
- Various tests to receive loan and qualify for forgiveness

# Employee Retention Credit

- Refundable credit against applicable employment taxes
- Multiple factors go into the qualification process

| | 2020 | 2021 |
|---|---|---|
| Credit (% of Qualified Wages) | 50% | 70% |
| Max. Qualified Wages | $10,000 (Annual Basis) | $10,000 (Quarterly Basis) |
| Maximum Credit | $5,000 | $28,000 |
| Decline in Gross Receipts | Greater than 50% | Greater than 20% |
| Employee Threshold | 100 | 500 |
| Employers with PPP Loans* | Eligible | Eligible |

# Temporary Favorable Changes to the Tax Code

- Increase in the limitation of charitable contributions for individuals
- Waivers of penalties on early retirement account distributions for individuals
- Suspension of Excess Business Loss Limitations
- Five year NOL Carrybacks
- Changes to Interest Limitations for businesses

- Where We Stand Today and Latest Tax Proposals

# Where we stand today

- Infrastructure Investment and Jobs Act
  - $1.2 trillion
  - Focus primarily on economy and physical infrastructure
  - Bipartisan Bill
  - Senate Passed on August 10
- Build Back Better Act
  - $3.5 trillion
  - Focus primarily on human infrastructure
  - No Republican backing, strictly partisan

# Where we stand today

- Both proposed bills stalled with the House on October 1
- Democratic progressives and moderates disagree on the price tag and the scope of the $3.5 trillion Build Back Better Act
- Progressive Democrats have refused to vote on the Infrastructure Investment and Jobs Act until agreement on the Build Back Better Act is reached
- Pelosi has imposed an October 31 deadline to hold another vote for the $1 trillion bipartisan infrastructure bill and move the $3.5 trillion Build Back Better Act forward

# Tax Impact


- HOUSE COMMITTEE OF WAYS & MEANS TAX PROPOSALS
    - **Presented over $2 trillion in tax hikes on September 13 as part of Build Back Better Act**

# Summary of Ways & Means Tax Proposals

- Increase in corporate tax rate
- Increase in long term capital gains tax rate
- Exclusion of taxpayers with AGI over $400,000 from Qualified Small Business Stock (QSBS) exemptions
- Increase in Individual maximum tax rate
- Expansion of Net Investment Income Tax to include ordinary trade or business income (still excluding FICA wages) for earners with income greater than $400,000
- Surcharge tax on high income individual taxpayers
- Limitation on Section 163(j) business interest expense carryforward period
- Limitation on Qualified Business Income Deduction
- Estate and Gift Tax Changes

# Increase in Corporate Tax Rate

- Current flat rate of 21% replaced with a graduated rate structure.
  - 18% on first $400,000
  - 21% on income over $400,000 - $5 million
  - 26.5% on income over $5 million

# Increase in Long Term Capital Gains Tax Rate

- Current rate of 20% increased to 25%
- Applicable to taxable years ending after "the date of introduction of this Act", meaning it is possible that LTCG rates could be higher on certain 2021 transactions which should be factored in and closely monitored for any 2021 disposition/transaction planning

# Qualified Small Business Stock (QSBS) Exemptions Exclusion

Exclude Taxpayers With AGI Over $400,000 From Qualified Small Business Stock (QSBS) Exemptions

Currently capital gains from QSBS are exempt from federal taxes. The proposal amends section 1202(a) of the tax code to limit special 75% and 100% exclusion rates to taxpayers with an adjusted gross income less than $400,000. However, the baseline 50% exclusion rate would still be available to all taxpayers.

# Increase in Individual Maximum Tax Rate

- Maximum tax rate would increase from 37% back to the 39.6% rate from before The Tax Cuts and Jobs Act

| ***Effective Date: Beginning after 12/31/2021*** | ***39.6% rate applies*** |
|---|---|
| *MFJ* | *$450,000* |
| *HH* | *$425,000* |
| *Single* | *$400,000* |
| *MFS* | *Over $225,000* |
| *Estates and Trusts* | *Over $12,500* |

# Net Investment Income Tax Expansion

- Expansion of the current 3.8% (Obamacare) net investment income tax to be assessed on ordinary trade or business income
- Currently only applies to interest, dividends, capital gains, rental and royalty income, nonqualified annuities, and income from businesses that are passive activities
- Expansion will only apply to MFJ taxpayers with taxable income over $500,000 or single taxpayers with taxable income over $400,000
- Business income subject to self-employment tax would continue to be excluded from Net Income Tax
- Especially significant for 100% S Corporation shareholders and owners of real estate partnerships

# Surcharge Tax on High Income Individuals

- Additional 3% tax surcharge for individuals that have AGI in excess of $5 million


# Limitation on Section 163(j) business interest expense carryforward period

- Interest disallowed in a taxable year after 2021 can no longer be carried forward indefinitely but would be limited to a five-year carryforward

# Limitation on Qualified Business Income Deduction

| *Effective Date: Beginning after 12/31/2021* | *Maximum 199A* | *Maximum QBI* |
|---|---|---|
| *MFJ, SS* | *$500,000* | *$2,500,000* |
| *HH, Single* | *$400,000* | *$2,000,000* |
| *MFS* | *$250,000* | *$1,250,000* |
| *Estate or Trust* | *$10,000* | *$50,000* |

- Pass through deduction of 20%, applicable to certain qualified business income (199A), would now be capped at $500k
- Currently unlimited

# Corporation vs Pass-Through Comparison

| Entity Type | Current | Proposed |
|---|---|---|
| Corporation | | |
| Without Surcharge Tax | **39.8 percent** (21% + (0.79 * 23.8%)) | **47.7 percent** (26.5% + (0.735 * 28.8%)) |
| With Surcharge Tax (3%) | **39.8 percent** (21% + (0.79 * 23.8%)) | **49.9 percent** (26.5% + (0.735 * 31.8%)) |
| Pass-through | | |
| With qualified business income deduction | **29.6 percent through 2025** (37% * 80%) | **35.5 percent** ((39.6% * 80%) + 3.8%) (up to $2.5M income) |
| Without qualified business income deduction | **37 percent through 2025** (37% * 100%) | **43.4 percent** (39.6% + 3.8% ) |

# Estate and Gift Tax Changes

- Lowers lifetime exemption from $11.7 million to $5.9 million
- Eliminates valuation discounts
- Grantor trusts would now be includable in estate

# Items of Note Omitted in Ways & Means Proposals

- Section 1031 Exchanges for real estate companies
- $10,000 limitation on state and local tax deduction
- 15% minimum tax on corporations with over $2 billion of income
- Carbon tax
- Related to estates, the preservation of step-up in basis and no taxation of capital gains at death

- Tax Planning Opportunities

# Tax Planning Opportunities for 2021 and Beyond

- Accelerate income
- Percentage of Completion
- Defer deductions (non-job related)
- Forego bonus depreciation
- Defer large charitable contributions until 2022
- Accelerate gain recognition and defer losses
- Elect out of installment sales
- Convert traditional IRAs to Roth IRAs
- Accounting method changes

- International Tax Update

# Summary of International Tax Planning

- Choice of Entity
- Tax Treaty Considerations
- Local Country Tax Obligations
- U.S. GILTI Regime
- Foreign Derived Intangible Income (FDII)
- Tax Reform Again?

# Choice of Entity

- When entering into a project outside the US, the home office can structure the project in a few different ways
  - Branch of the parent or U.S. subsidiary
  - Foreign subsidiary of the parent
  - Hybrid entity
    - Subsidiary for local purposes branch or partnership for U.S. purposes (check the box)

# Choice of Entity

- Things to consider in choosing entity type
  - Local country taxation
  - Length of project, or multiple projects
  - Cost of liquidating foreign company
  - Risk mitigation
  - Need for a local JV partner
  - Ability to charge HQ expenses
  - U.S. taxation / entity classification of the U.S. parent

# Tax Treaties

- Provide the basis for taxation of nonresidents (individuals and corporations)
  - Define basic concepts such as residence and permanent establishment
  - Specific provisions for construction and engineering projects
- Provide tax relief in case of double taxation
- Provide for a reduction in withholding tax

# Tax Treaties

- Construction Projects Example
  - Article V of the U.S. Canada Tax treaty
  - The right to tax a resident of the other contracting state is limited to situations where the profits are earned through a permanent establishment (PE)
  - A PE is created in the case of a construction site only if the project lasts more than 12 months

# Local Tax Considerations

- Import Duties on equipment and materials
- VAT registration and compliance
  - May be required even if no PE for income tax
- Payroll Taxes for local employees and Expats
- Income Tax and Estimated Tax filings
- Transfer Pricing

# U.S. Global Intangible Low-Taxed Income Regime

- The stated purpose of GILTI was to currently tax highly mobile intangible foreign income
  - They missed badly
  - It currently taxes income from foreign subsidiaries that is in excess of a deemed 10% return on fixed asset investment
  - C corporations get deduction of 50%
    - Creates an effective rate of 10.5%
  - 10% or more S corp Shareholders and Partners must make additional elections to get the benefit

# Foreign Derived Intangible Income Deduction (FDII)

- Available to C Corps only
- Deduction equal to 37.5% of the intangible income of foreign projects
  - Deduction is reduced to 21.875% in 2026
- Essentially the profit on your foreign construction contracts in excess of a deemed return on tangible assets

# Tax Reform Again

- Corporate Tax Rate to increase
- Individual Tax Rate to increase
- GILTI Tax Rate to Increase
- FDII Deduction will decrease
  - May move toward an innovation deduction
- Country by Country FTC calculation
- IC DISC's may provide a bigger benefit
- Impact of Global Tax Reform

# Questions?


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