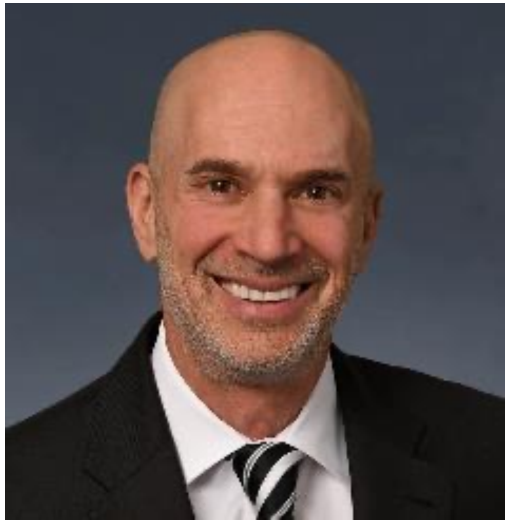
2022 Tax Update

Denver Estate Planning Council
Dan Seff, Senior Managing Director, CBIZ

JANUARY 20, 2022

Presenter



Dan Seff
Senior Managing Director
CBIZ Colorado

Dan is the Senior Managing Director of the CBIZ & MHM Colorado office and a member of the MHM Board of Directors. He is responsible for the overall management of the Colorado market, including financial performance, strategic planning efforts, and client satisfaction. A Certified Public Accountant and Certified Valuation Analyst, he has been providing tax, accounting and consulting services to middle-marketing companies and their owners for over 30 years.

720.200.7000 | dseff@cbiz.com

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Disclaimer

The information in this seminar is a brief summary and may not include all the details relevant to your situation.

Please contact your service provider to further discuss the impact on your business.

Agenda

1. Tax Law Changes Impacting 2022
2. Individual Tax Planning Strategies
3. Executive Compensation
4. Business Entity Structuring and Succession Planning

Tax Law Changes Impacting 2022 and Beyond

Timeline of 2021 Tax Legislation

- March 31: American Jobs Plan announced by President Biden
- April 28: American Families Plan announced by President Biden
- May 28: Treasury Dept. Green Book details on tax plans released
- Aug. 10: Infrastructure Investment and Jobs Act passes Senate
- Sept. 13: House releases blueprint for Build Back Better Act
- Nov. 19: House passes Build Back Better Act

Status of Tax Legislation

- The Infrastructure Investment and Jobs Act (IIJA) was signed into law November 15, 2021
  - This is the bill that focuses on “hard infrastructure” initiatives such as roads, bridges, and airports
  - The IIJA also contains a few tax provisions, such as:
    - Ending the Employee Retention Credit early by making the fourth quarter of 2021 ineligible
    - Imposing new information reporting requirements for cryptocurrency transactions, beginning in 2023 and 2024
- Congress is continuing negotiations over the Build Back Better Act (BBBA)
  - Passed the House on November 19, currently with the Senate
  - The following slides detail some of the major provisions within the BBBA, and compare them with previous plans and proposals

EMPLOYEE RETENTION CREDIT
What You Need To Know

ERC Time Period

2020 ERC	2021 ERC
March 13, 2020 through December 31, 2020	January 1, 2021 through September 30, 2021* ** extended to December 31, 2021 for selected start-up companies

Maximum Credit

2020 ERC	2021 ERC
• The maximum 2020 ERC that can be claimed is 50% of qualified wages per employee.	• The maximum 2021 ERC that can be claimed is 70% of qualified wages per employee in each quarter.
• Qualified wages are capped at $10,000 per employee, thus the maximum credit per employee is $5,000.	• Qualified wages are capped at $10,000 per employee, thus the maximum credit per employee is $7,000 per quarter for a total of $21,000 per employee through September 30, 2021.

Implications of Employer Size

2020 ERC	2021 ERC
• Businesses with 100 or fewer employees can claim the ERC for all wages whether the employees were performing services or not.	• Businesses with 500 or fewer employees can claim the ERC for all wages whether the employees were performing services or not.
• When calculating the 100-employee threshold, the employees of all affiliated companies sharing more the 50% common ownership are aggregated.	• When calculating the 500-employee threshold, the employees of all affiliated companies sharing more the 50% common ownership are aggregated.

Provisions - Individuals

Provision	Am. Families Plan April 28, 2021	Green Book May 28, 2021	Ways and Means Sept. 13, 2021	House Passed HR 5376 Nov. 15, 2021
Ordinary Income Tax Rate	Top rate increased to 39.6%	Top rate increased to 39.6% for $509,300 MFJ, $481,000 HoH, and $452,700 Single	Top rate increased to 39.6% for $450,000 MFJ, $425,000 HoH, and $400,000 Single	No provision
Long Term Capital Gains Tax Rate	39.6% for all LTCG and dividends over $1 million per household	37% for all LTCG and dividends over $1 million per household (S or MFJ)	Maximum rate 25%	No provision
Net Investment Income Tax (NIIT)	"Consistently apply" the NIIT to "those making over $400,000"	Expand NIIT to cover all trade or business income from partnerships and S corporations, for TPs with AGI over $400,000	**After 2021** - Expand NIIT to cover all trade or business income from partnerships and S corporations, for filers with AGI over $500,000 (MFJ) or $400,000 (S)	**After 2021** - Expand NIIT to cover all trade or business income from partnerships and S corporations, for filers with AGI over $500,000 (MFJ) or $400,000 (S)
Income Tax Surcharge	No provision	No provision	**After 2021** - 3% surcharge on modified AGI (less investment interest expense) over $5 million	**After 2021** - 5% surcharge on AGI (less invest. int. exp.) over $10 million (MFJ, S) or $5 million (MFS); 8% surcharge on AGI over $25 million (MFJ, S) or $12.5 million (MFS)

Provisions - Individuals

Provision	Am. Families Plan April 28, 2021	Green Book May 28, 2021	Ways and Means Sept. 13, 2021	House Passed HR 5376 Nov. 15, 2021
State and Local Tax Deduction	No provision	No provision	No provision	**After 2020** - Raise "SALT cap" from $10,000 to $72,500 (S, MFJ, or HoH) or $36,250 (MFS), but extend the SALT cap through 2031
Other Deductions and Credits	No provision	Credit up to $5,000 for 25% of homeowner disaster mitigation expenses	Repeal disaster limitation for personal casualty and theft losses	No provision
Carried Interest	"Close the carried interest loophole" permanently	All income from carried interest subject to ordinary tax rates for taxpayers with income over $400,000	Extend holding period from 3 to 5 years in order to obtain favorable tax rates for taxpayers with AGI over $400,000	No provision
Section 1202	No provision	No provision	No 75% or 100% exclusion for taxpayers with AGI over $400,000	No 75% or 100% exclusion for taxpayers with AGI over $400,000

Provisions - Individuals

Provision	Am. Families Plan April 28, 2021	Green Book May 28, 2021	Ways and Means Sept. 13, 2021	House Passed HR 5376 Nov. 15, 2021
IRA Contribution Restriction	No provision	No provision	No contributions (Roth or Traditional) if account value over $10 million, for taxpayers with taxable income over $400,000 (S or MFS) $450,000 (MFJ), or $425,000 (HoH)	No contributions (Roth or Traditional) if account value over $10 million, for taxpayers with taxable income over $400,000 (S or MFS) $450,000 (MFJ), or $425,000 (HoH)
Increase to Required Minimum Distributions	No provision	No provision	**After 2021** - RMD of 50% of balance over $10 million, and 100% for accounts over $20 million	**After 2028** - RMD of 50% of balance over $10 million, and 100% for accounts over $20 million
Backdoor Roth IRA Conversions	No provision	No provision	Eliminate ability to make backdoor Roth IRA contributions **after 2021**, for all taxpayers	Eliminate ability to make backdoor Roth IRA contributions **after 2021**, for all taxpayers
IRA Investments in Owner's Business	No provision	No provision	Ownership threshold for owner's business lowered from 50% to 10% to determine prohibited investments; owner cannot be an officer	No provision

Provisions - Businesses

Provision	Am. Jobs Plan March 31, 2021	Green Book May 28, 2021	Ways and Means Sept. 13, 2021	House Passed HR 5376 Nov. 15, 2021
Corporate Tax Rates	28% flat rate	28% flat rate	18% up to $400K 21% $400K-$5 million 26.5% over $5 million	No provision
Book Inc. Min. Tax	15% minimum tax on book income for "the very largest corporations"	15% minimum tax on corporations with worldwide book income over $2 billion	No provision	15% minimum tax on corporations with worldwide book income over $1 billion
R&E Expenses	No provision	No provision	Delay capitalization and amortization of R&E expenses from 2022 to 2026	Delay capitalization and amortization of R&E expenses from 2022 to 2026
Highly-Paid Officer Comp	No provision	No provision	Accelerate effective date of elimination of excess compensation of public company highly paid employee deduction from 2026 to 2022	Compensation includes performance-based compensation, commissions, severance, and beneficiary payments
Business Interest Exp. Limitation	No provision	Impose interest expense limitation on certain members of a financial reporting group	Impose interest expense limitation on certain members of a financial reporting group; move 163(j) calculation from pass-thru level to owner level	Impose interest expense limitation on certain members of a financial reporting group; move 163(j) calculation from pass-thru level to owner level

Provisions - Businesses

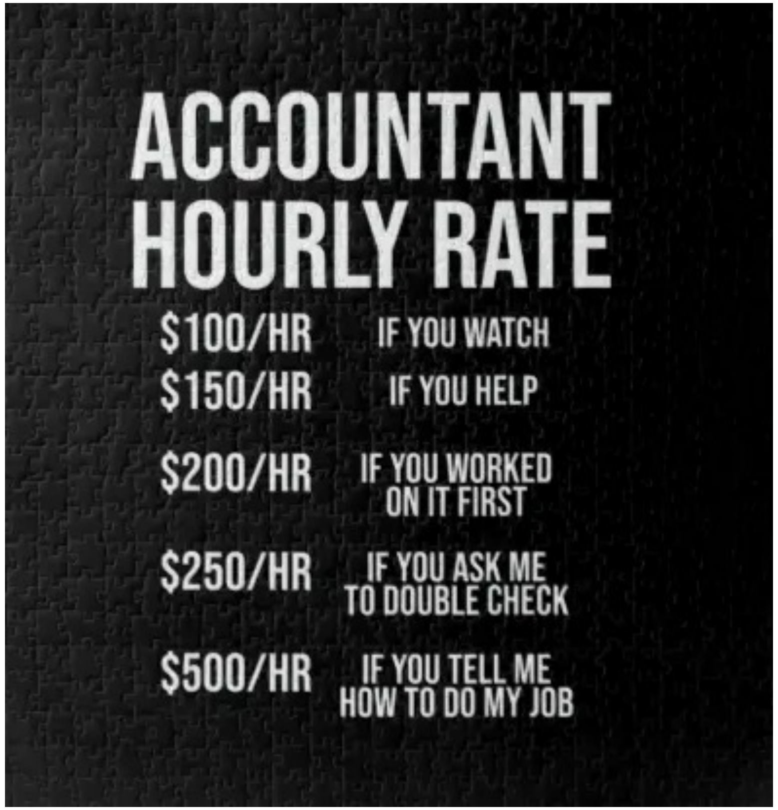
Provision	Am. Families Plan April 28, 2021	Green Book May 28, 2021	Ways and Means Sept. 13, 2021	House Passed HR 5376 Nov. 15, 2021
Excess Business Loss Limitation	Permanently extend excess business loss limitation, which is scheduled to expire after 2026	Permanently extend excess business loss limitation, which is scheduled to expire after 2026	**After 2021** - Permanently extend excess business loss limitation, which is scheduled to expire after 2026; treat loss carryovers as again subject to the \$250K (S) / \$500K (MFJ) limitation instead of treating as NOLs	**After 2020** - Permanently extend excess business loss limitation, which is scheduled to expire after 2026; treat loss carryovers as again subject to the \$250K (S) / \$500K (MFJ) limitation instead of treating as NOLs
Qualified Business Income Deduction	No provision	No provision	After 2021 - Deduction capped at \$400,000 (S), \$500,000 (MFJ), or \$250,000 (MFS)	No provision
Like-Kind Exchanges	Like-kind exchange gains greater than \$500K cannot be deferred	Like-kind exchange gains greater than \$500K or \$1 million (MFJ) cannot be deferred	No provision	No provision

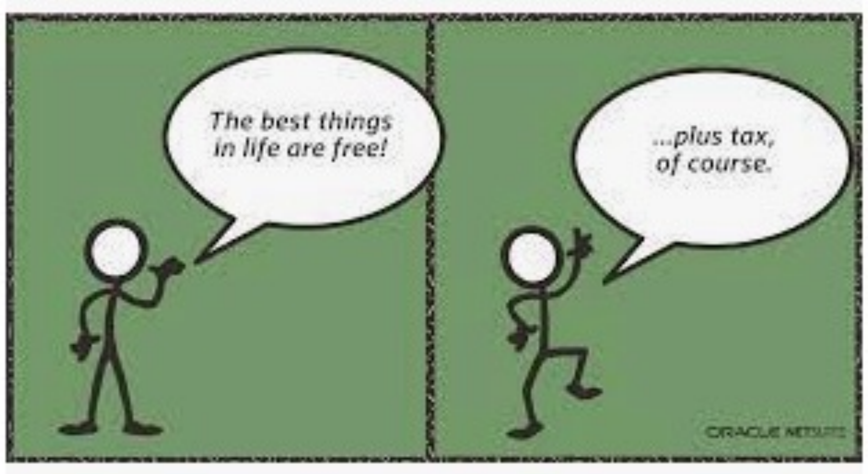
Provisions – Estate and Gift Taxes

Provision	Am. Families Plan April 28, 2021	Green Book May 28, 2021	Ways and Means Sept. 13, 2021	House Passed HR 5376 Nov. 15, 2021
Lifetime Exclusion	No provision	No Provision	Reduce to $5 million	No provision
Basis Step Up	No basis step up in excess of $1 million – protection for family-owned businesses	Transfers by gift or on death would be taxable for gains in excess of $1 million per spouse; gains that have not had a recognition event in the past 90 years would be deemed realized when transferred to or from a pass-thru entity	No provision	No provision
Grantor Trusts	No provision	No provision	Include in decedent's gross estate; sales between grantor trust and the grantor would be taxable transactions	No provision
Valuation Discount	No provision	No provision	Eliminate for nonbusiness assets transferred to recipient having minority ownership	No provision

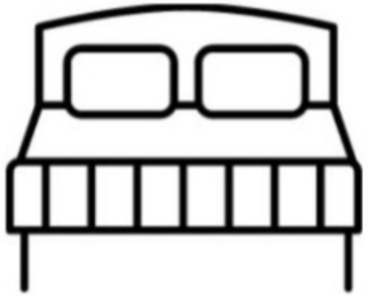
Provisions – IRS Enforcement and Compliance

Provision	Am. Families Plan April 28, 2021	Green Book May 28, 2021	Ways and Means Sept. 13, 2021	House Passed HR 5376 Nov. 15, 2021
Funding	Increase on enforcement of “wealthy” individual taxpayers	Give IRS $72.5 billion over 10 years	Give IRS $80 billion over 10 years (cannot use on taxpayers with income under $400K)	Give IRS $79 billion over 10 years (cannot use on taxpayers with income under $400K)
Reporting	More bank reporting obligations	Comprehensive financial account reporting for gross inflows and outflows in excess of $600	No provision	No provision
Crypto Reporting	No provision	Expand reporting for brokers (broadly defined) - $600 (like 1099) requirement and $10,000 (like CTR) requirement	No provision (included in IIJA)	No provision (included in IIJA)
Partnership Audits	No provision	Amend to address tax decrease greater than a partner’s income tax liability	No provision	No provision





What kind of bedding does an accountant have?



Balance Sheets

Individual Tax Planning Strategies

2022 Tax Rates and Brackets

Tax Rate		Filing Status	
Ordinary Income	Long-Term Capital Gain	Married Filing Jointly	Single
10%	0%	Up to $20,550	Up to $10,275
12%	0%	$20,551 to $83,350	$10,276 to $41,675
12%	15%	$83,351 to $83,550	$41,676 to $41,775
22%	15%	$83,551 to $178,150	$41,776 to $89,075
24%	15%	$178,151 to $340,100	$89,076 to $170,050
32%	15%	$340,101 to $431,900	$170,051 to $215,950
35%	15%	$431,901 to $517,200	$215,951 to $459,750
35%	20%	$517,201 to $647,850	$459,751 to $539,900
37%	20%	Over $647,850	Over $539,900

Note: Ordinary income represents the first “layer” of income; the long-term capital gains rate is based on the next layer of income consisting of long-term capital gains

Select Inflation Adjustments for 2022

- IRA Contributions
  - $6,000 maximum contribution
  - $1,000 catch up for taxpayers age 50 or over
  - Deductible contributions phased out after:
    - AGI > $109,000 (MFJ, taxpayer covered, spouse covered or uncovered)
    - AGI > $204,000 (MFJ, taxpayer not covered, spouse covered)
    - AGI > $68,000 (Single or Head of Household, taxpayer covered)
    - AGI > $0 (MFS, either spouse covered)
  - No phase out if neither taxpayer nor spouse (if applicable) are covered in a retirement plan

Select Inflation Adjustments 2022

- Roth IRA Contributions
  - $6,000 maximum contribution
  - $1,000 catch up for taxpayers age 50 or over
  - Eligible contributions phased out after:
    - MFJ or QW: AGI > $204,000
    - Single or HOH: AGI > $129,000
    - MFS: AGI > $0
- 401(k) Contribution
  - $20,500
  - $27,000 per person age 50 or over

Select Inflation Adjustments for 2022

- Kiddie Tax Unearned Income Threshold
  - Amounts over $2,300 are taxed using the parent's incremental tax increase had the child's unearned income been included with the parent's tax return (*i.e.*, parent's highest marginal rate)
- Social Security wage base for 6.2% tax
  - $147,000
- Gift Tax Annual Exclusion
  - $16,000 per donee
  - $164,000 per noncitizen spouse
- Estate Tax Lifetime Exclusion
  - $12,600,000 per individual

Charitable Giving

- Planning ideas for charitable contributions
  - Consider donation of appreciated publicly traded stock
    - Can claim deduction equal to fair value on donation date
    - Gain inherent on stock is nontaxable
    - Stock must be held prior to donation for more than 1 year
    - Deduction cannot exceed 30% of AGI (20% for nonoperating private foundations)
  - Consider charitable IRA rollover
    - Up to $100,000 in a single year per IRA owner age 70 ½ or older
    - IRA distribution satisfies minimum required distribution and is not included in taxable income
    - Not subject to limit on charitable deductions, and not deductible as charitable contribution
    - Eligible for traditional or Roth distributions, but Roth distribution will not provide a tax incentive
    - Certain private foundations and donor advised funds not eligible

Health Care Accounts

- Flex Spending Account (“FSA”)
  - Employer-sponsored account, up to $2,850 per year in 2022
  - Account typically funded with employee’s pre-tax salary
  - Reimbursements to employee from account for qualified medical, dental or dependent care expenses
  - Generally “use it or lose it” policy by December 31; certain plans allow either a 2 ½ month grace period after December 31, or a $500 roll over provision
- Health Savings Account (“HSA”)
  - Typically established with employer’s involvement
  - For 2022, up to $3,650 for self-only coverage or $7,300 for family coverage can be funded with employee’s pre-tax salary (additional $1,000 for individuals age 55 and older)

Investments

- Sales of capital assets (*e.g.*, publicly traded stock)
  - Short term capital gains taxed as ordinary income
  - Long term capital gains tax rate varies with the individual tax brackets. For 2022:
    - 0% rate applies with AGI up to $80,800 (MFJ), $40,400 (Single)
    - 15% rate applies with AGI up to $501,600 (MFJ), $445,850 (Single)
    - 20% rate applies for AGI in excess of these levels
  - Long term capital gains tax rate is determined by treating ordinary income as the first "tier" of income, with capital gains as the last "tier"
    - Capital gains can therefore be taxed partially at one of the above rates, with a residual at the next higher of the above rates

Investments

- Sales of capital assets (cont'd)
  - Consider "loss harvesting" within an investment portfolio that has year-to-date capital gains
    - Financial advisors can assist to identify securities appropriate for sale to generate a loss
    - Financial advisors can then assist with reinvestment into a similar investment position to maintain overall strategy
    - Loss on sale will offset previous year-to-date gains otherwise subject to capital gains tax
  - Be Mindful of Wash sale rule
    - Loss on sale of a security suspended if a substantially identical security is purchased 30 days before or after
    - Consider purchase of additional shares equal to the number desired for sale, and wait 31 days to sell the original shares

Investments

- Sales of capital assets (cont'd)
  - Consider gain deferral strategies
    - Like-kind exchange provides for gain deferral when similar properties are exchanged
      - Now limited exclusively to exchanges of Real Property
    - Installment sales provide for gain deferral (except for publicly-traded stock) when immediate cash payment is not required, whereby the gain is spread over the subsequent period in which cash is collected
    - Investment in Qualified Opportunity Zone Funds offers yet another deferral opportunity
      - New program enacted by the passage of the TCJA which has similar qualities to other existing tax credit programs

Investments – QOZ’s

- Sales proceeds attributable to amounts that would otherwise be taxed as capital gains that are re-invested into a fund for a QOZ allow the capital gains to be deferred
  - Only the “gain” can be reinvested, not the entire proceeds
  - Length of deferral lasts as long as the QOZ investment is held, or until Dec. 31, 2026 if sooner
- 10% of deferred capital gain is never recognized if QOZ investment is held for 5 years
- Another 5% of deferred capital gain is never recognized if QOZ investment is held for 7 years
- And, ALL appreciation in value of the QOZ investment is permanently excluded from tax if the QOZ investment is held for 10 years

Investments – QOZ Deadlines

- Dec. 31, 2019 – Last day to invest in QOF to be eligible to receive ALL potential tax benefits (including the 15% basis increase on deferred gain)
- Dec. 31, 2021 – Last day to invest in QOF to be eligible to receive the 10% basis increase on deferred gain
- Dec. 31, 2026 – All previously deferred capital gains, less basis increases, must be included in income
- Jun. 29, 2027 – Last possible day to invest in a QOF
- Dec. 31, 2047 – Last day to sell a QOF investment and elect to step up the basis of such investment to fair market value (to permanently exclude from tax any gains realized on the QOF investment)

Investments

- Net Investment Income Tax (NIIT)
  - Applies to individuals with MAGI > $250,000 (MFJ); $200,000 (Single, Head of Household); $125,000 (MFS)
  - 3.8% tax in addition to ordinary / capital gains tax
  - Included in Net Investment Income:
    - Interest, Dividends
    - Capital gains
    - Certain annuity distributions
    - Rents (unless a qualifying trade or business)
    - Royalties
    - Income from passive activities
  - Planning to reduce tax on investments (*e.g.*, capital gains) also helps to avoid or defer the net investment income tax

"I understand where you're coming from, but I don't think the government will recognize your brother-in-law as a charity."

"Even if your dog does do 'his business' in your basement, you still can't deduct it as office space."

Net Investment Income Tax interplay with TCJA

- Deductibility of Investment Expenses when calculating NIIT liability:
  - The TCJA suspended Misc. Itemized Deductions, many of which include investment related expenses incurred to produce Investment Income
  - Because NIIT deductions can be taken only to the extent they are deductible for income tax purposes, these investment related expenses are also non-deductible when calculating the NIIT (for tax years 2018-2025)
    - Taxpayers remain entitled to deduct investment interest expenses, up to net investment income, as calculated on Form 4952
  - Note that a §266 election will not be an effective tactic either, as the IRS has stated taxpayers could not capitalize investment management fees under §266 because they are managerial rather than transactional

Investments

- Sec. 1244 Small Business Stock
  - Generally stock issued by a small business corporation (aggregate capitalization of corporation < $1 million)
  - Ordinary loss on sale or worthlessness up to $100,000 (MFJ); $50,000 (Single)
  - Holding period not relevant
  - Greater tax benefit by virtue of higher tax rates on ordinary income offset, and no $3,000 annual limitation applicable to net capital losses
- Sec. 1202 Small Business Stock
  - Generally original issuance stock by a “small” corporation (corporation’s gross assets < $50 million)
  - At least 80% of issuing corporation’s assets used in “qualified trades or businesses” during span of investment

Investments

- Sec. 1202 Small Business Stock (cont'd)
  - 100% gain exclusion from sale of stock acquired after 9/27/10 (subject to 10x basis or $10 million cap, whichever greater)
    - 75% exclusion for stock acquired 2/18/09 – 9/27/10
    - 50% exclusion for stock acquired before 2/18/09
  - Non-excluded gain subject to 28% capital gains tax rate, or marginal ordinary tax rate if lesser
  - Must hold stock for more than 5 years
  - "Qualified trades or businesses" generally are any type other than services based on reputation or skill of employees (*e.g.*, health, law, architecture, financial), banking, insurance, finance, leasing, farming, restaurant, inn-keeper, or natural resource extraction

Investments

- Sec. 1202 Small Business Stock (cont'd)
  - Prior to completion of 5-year holding period, investor may sell one qualified small business and invest in another qualified small business, without recognizing gain
    - Re-investment of proceeds must occur within 60 days of sale
    - Original investment must be held for more than 6 months
    - Holding period of original investment "tacks" to new investment (to potentially allow for the 100% gain exclusion at a later date)
    - Gain is deferred and reduces basis in the new stock

Retirement Plan Contribution Strategies

- There are varying types of tax-advantaged retirement plan savings strategies, depending on whether the taxpayer is an individual or a business owner
- For individuals, Roth IRAs provide for tax-free distributions in retirement years, but contributions do not reduce current taxable income
- Roth IRA contributions subject to limitations, cannot be made (for 2022) if:
  - AGI > $204,000 (MFJ, both active participants in other plan)
  - AGI > $129,000 (Single or Head of Household, and active participant in other plan)
  - AGI > $0 (MFS)
- No limitation for Roth 401(k) contributions
- No limitation for conversions of Traditional IRAs to Roth
  - Converted value is taxable in year of conversion

Retirement Plan Contribution Strategies cont.

- Change to Roth IRA Conversions:
  - The TCJA has removed the ability to re-characterize any Roth IRA conversions done in 2019 and onward
- Individuals over the AGI limit for Roth contributions should consider “back door” Roth IRA
  - A nondeductible contribution is first made to a Traditional IRA account
  - Shortly after the contribution (*e.g.*, when there is little growth), the balance is converted to a Roth account
  - Since conversions have no limitation, the individual effectively accomplished a “back door” Roth contribution

Tax Trap:* *This strategy only works if the individual does not have any other Traditional IRA balances in any account with any custodian

Retirement Plan Contribution Strategies

- Business owners can establish a retirement savings vehicle that allows for much higher contributions than those described in the previous discussion about IRA benefits for individuals
- Common types of retirement savings vehicles for businesses include “defined contribution plans,” of which there are many types, including:
  - SEP (simplified employee pension) plans
  - SIMPLE (savings incentive match plan for employees) plans
  - Qualified plans such as 401(k) plans or profit sharing plans
- The following two slides compare and contrast the manner in which these common types of plans can be funded, the funding limits, eligibility criteria, and other administrative concerns

Retirement Plan Contribution Strategies

	SEP-IRA	SIMPLE IRA / SIMPLE 401(k)	Qualified Plan (Defined Contribution)	
			Profit Sharing	401(k)
Description	Simplified method to fund retirement benefits for owners and employees -- directly into participant IRAs based on discretionary employer contributions	Simplified method to fund retirement benefits for owners and employees -- based on employee salary deferrals and matching employer contributions	Incentivized manner to fund retirement benefits for owners and employees -- based on employer contributions with respect to employer-defined "profits"	Flexible method to fund retirement benefits for employees -- based on employee salary deferrals and matching employer contributions
Funding	• Employer (optional)	• Employer **(required)** • Employee (optional)	• Employer (optional)	• Employer (optional) • Employee (optional)
Contribution Limit (2021)	Lesser of **$58,000** or 25% of participant's compensation	• Employee deferral **$13,500** (+$3,000 catch-up age 50+) • Employer match up to 3% of employee's compensation	Lesser of **$58,000** or 25% of participant's compensation	• Employee deferral **$19,500** (+$6,500 catch-up age 50+) • Employer match up to 100% of employee's compensation (not to exceed $58,000 total contribution)

Retirement Plan Contribution Strategies

	SEP-IRA	SIMPLE IRA / SIMPLE 401(k)	Qualified Plan (Defined Contribution)	
			Profit Sharing	401(k)
Employer Eligibility	Any employer	Employers with no more than 100 employees (not counting employees who earn < $5,000)	Any employer	Any employer
Employee Eligibility	Must include all employees who: • Are 21+ years old • Are employed for 3 of the 5 preceding years, and • Have compensation $650+	Must include all employees who have compensation $5,000+ in any 2 preceding calendar years and who are reasonably expected to earn $5,000+ in the current year	Must include all employees who: • Are 21+ years old, and • Performed at least 1 year of service	Must include all employees who: • Are 21+ years old, and • Performed at least 1 year of service
Form 5500 Filing	Not required if employer provides employee with a copy of employer's Form 5305-SEP together with written notification of contribution amount	• SIMPLE IRA – not required • SIMPLE 401k – required	Required	Required

Retirement Plan Contribution Strategies

- Business owners can also establish a “cash balance plan,” which is a form of a defined benefit plan
  - Such plans may be adopted after tax year-end and treated as if adopted during the tax year
- Nuances of a cash balance plan:
  - Defines the lump sum benefits rather than the annuity benefits; looks like a defined contribution plan
  - Benefits based on a hypothetical account
    - Annual contribution credits to hypothetical account per plan document
    - Guaranteed interest crediting rate (fixed or variable, often 5%)
    - Ongoing hypothetical account balances are maintained
    - More tangible appearance for employees
  - Maximum contributions based on present value of annuity at retirement age

Education Tax Incentives

- Individuals have various opportunities through tax deductions, credits, and tax-preferred savings vehicles for education, but all are subject to income limitations except for 529 savings plans
  - 529 plan contributions, while not deductible, allow for tax deferred growth and tax-free distributions
    - Are still subject to gift tax, so be mindful of annual gift exclusion amounts
  - TCJA expanded utility of 529 plans to allow for money to be spent on private K-12 education
  - American Opportunity Credit and Lifetime Learning Credit
    - Credit amounts range up to $2,500, phased out for income levels exceeding:
      - AOC: $160,000 (MFJ), $80,000 (Single) (not indexed for inflation)
      - LLC: $119,000 (MFJ), $59,000 (Single) (2021 amounts)

Education Tax Incentives

- Individuals opportunities (cont'd)
  - Deduction for tuition and fees from taxable income no longer available (repealed by new tax law)
  - Deduction for $2,500 max student loan interest available but phase out in 2022 starts at $145,000 (MFJ), $70,000 (Single)
  - Coverdell Education Savings Accounts available, and are similar to 529 plans, but also allow for savings toward elementary and secondary school expenses
    - Are subject to income limits, where ability to contribute is phased out in 2021 at $220,000 (MFJ), $110,000 (Single) (not adjusted for inflation)
    - Can only contribute $2,000 per year, per beneficiary

What's 2 + 2 ?

ENGINEER: "It lies between 3.98 and 4.02."

MATHEMATICIAN: "In 2 hours I can demonstrate it equals 4 with the following proof."

PHYSICIST: "It's in the magnitude of 1×10^1."

LOGICIAN: "This problem is solvable."

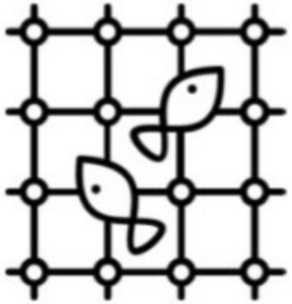
SOCIAL WORKER: "I don't know the answer, but I'm glad we discussed this important question."

ATTORNEY: "In the case of Smith vs State, 2 + 2 was declared to be 4."

TRADER: "Are you buying or selling?"

ACCOUNTANT: "What would you like it to be?"

What did the revenue fish say to the expense fish?



"Net incoming!"

Executive Compensation

Executive Compensation

- Nonqualified Stock Options (“NQSOs”)
- Incentive Stock Options (“ISOs”)
- Employee Stock Purchase Plan (“ESPP”)
- Restricted Stock and the 83(b) Election
- TCJA addition of Section 83(i) Deferral
- Nonqualified Deferred Compensation (“NQDC”)

Nonqualified Stock Options (NQSOs)

- Holder of NQSO taxable upon exercise on difference between exercise price and FMV of stock, assuming stock received from exercise is not "restricted"
  - If stock received from exercise is restricted (resale, forfeiture risk, etc.), taxation occurs when restrictions are removed. Recipient should consider 83(b) election on exercise date to "lock in" taxable value earlier, as of the exercise date (additional 83(b) discussion to follow)
  - While uncommon, an NQSO that has a "readily ascertainable fair market value" (for instance, a publicly-traded stock option) will be taxable on the grant date to the extent of such value
- Holder can sell some or all of shares when exercised to pay the exercise price and the tax (a "cashless exercise")

Nonqualified Stock Options (NQSOs)

- Holder can also use existing company stock holdings to fund the exercise price. With a “stock swap,” the holder swaps enough existing shares to cover the exercise price
  - No gain recognized on swapped shares; carryover basis
- As 25% income tax withholding rate often applies on taxes due from exercise, holder will need to consider making additional estimated tax payments if the holder is in a higher tax bracket
- NQSOs can be granted to persons who are not employees, although non-employees will need to pay estimated taxes upon exercise

Planning Point:* *Non-employees may be able to use income from exercise of an NQSO to permit additional contributions to qualified retirement plans, thereby reducing the tax cost of the exercise

Incentive Stock Options (ISOs)

- Exercise of ISOs does not create taxable income at time of exercise
- Difference between exercise price and stock's FMV is AMT preference item
  - Increases stock basis for AMT purposes
- Long term capital gains rates apply to stock obtained under ISO, if additional requirements are met. Must not sell stock within either of the following times:
  - Two years from the date of grant
  - One year from the date of exercise
    - If sold within these times, ordinary tax rates result on difference between exercise price and fair value on exercise date

Incentive Stock Options (ISOs)

- Certain requirements apply to entitle the holder’s option grant to ISO treatment
  - Maximum value of stock that may first become exercisable in any one year is limited to $100,000
  - Must be granted under a shareholder-approved plan specifying class of employees to receive and number of shares to be issued
  - Plan must not run for more than 10 years, and option period must not run more than 10 years
  - Option holder must be employee during entire option period
  - ISOs are required to be issued with strike price no less than FMV of stock on grant date
  - Additional rules apply

Planning Point:* *Plan the timing of when ISOs are exercised to minimize the AMT burden

Employee Stock Purchase Plan (ESPP)

- Right granted to employees to purchase employer's stock at a discount
- Similar to ISOs, except ESPPs benefit all employees (not just executives)
  - All full-time employees with at least 2 years of service must have ESPP availability
  - Maximum value of stock exercisable in any one year is limited to $25,000
- Exercise of ESPPs does not create taxable income at time of exercise
- Sale of stock at least 2 years after the grant date and 1 year after the exercise date generally results in long term capital gains, except any discounted exercise price must be captured as ordinary income on the later sale date

Restricted Stock and the 83(b) Election

- Restricted stock used as additional compensation
- Stock subject to restrictions is taxable once those restrictions are eliminated or lapse
  - Tax consequences largely the same as those with NQSOs, except with restricted stock there is no exercise price
  - Ability to simultaneously sell shares to pay for payroll and income taxes may be limited if stock is illiquid
- 83(b) election available, allows holder to recognize the value of the restricted stock into taxable income before the restrictions (vesting periods) are eliminated or lapse
  - Value determined on election date, strategy beneficial if value is anticipated to be lower than on the later date when the restrictions are eliminated or lapse
  - Gains subsequent to election date taxed as capital gains

Restricted Stock and the 83(b) Election

- 83(b) election must be made within 30 days of receipt of stock
  - Election made by filing statement with same Service Center address where return is filed
  - Beginning 1/1/16, separate attachment of 83(b) election to tax return no longer necessary
- If restricted stock is forfeited or loses value subsequent to an 83(b) election, the holder cannot get a refund of tax paid pursuant to the original election
- Holder should consider estimated tax payments if stock is illiquid, or if sale of shares only funds a 25% income tax withholding rate (if the actual tax rate is higher)
- Sometimes stock retains resale restrictions even when holder pays full price. In this case, it is critical to make 83(b) election to preserve capital gain potential on appreciation subsequent to purchase (83(b) election in this case results in zero income)

Section 83(i) Deferral Election

- New Section 83(i) provides a new deferral feature for certain equity awards:
  - Under Section 83(i), “qualified employees” who are granted stock options or restricted stock units (RSU) and who later receive stock upon exercise of the option or upon settlement of the RSU (“qualified stock”) may elect to defer the recognition of income for up to five years if the corporation’s stock is not publicly traded
  - Qualified employees are those other than:
    - A 1 percent owner (or greater) of the corporation at any time during the current calendar year or during the preceding 10 calendar years;
    - Someone who is or has been the CEO or the CFO of the corporation or an individual acting in that capacity (or a member of the CEO or the CFO’s family); or
    - Someone who is one of the four highest compensated officers of the corporation for the current tax year or any of the 10 preceding tax years

Nonqualified Deferred Compensation (NQDC)

- Generally not subject to nondiscrimination rules
- Nondeductible by employers until employee recognizes NQDC income
- Employment taxes must be paid when services are rendered or when compensation is no longer subject to substantial risk of forfeiture (earlier than payment date)
- State tax consequences may exist when income is earned through an NQDC plan and recipient moves out of state before compensation is paid
- Section 409A provides rules for NQDC plans, including timing for deferral; penalties for noncompliance can be severe

What do you call an "inventory" of boats?

Finished goods available for sail

Business Planning

Dispositions of Business Property

- Installment Sales
- Like-Kind Exchanges
- Related Party Transactions

Installment Sales – Points to Remember

- Unless one elects out, gain (not loss) is reported under the installment method by default
- Not available for sales of inventory, partnership interests or publicly traded securities
- Depreciation recapture recognized in year of sale
- Sales to related parties may result in ordinary income or acceleration of gain
- Disposition of installment note will accelerate gain
- Large installment notes outstanding at year end (over $5 million) subject to additional interest charge

Planning Point*: *When multiple business assets are sold and some have less gain potential, an agreement to specifically allocate installment payments to particular assets can maximize tax deferral

Like-Kind Exchange Changes

- The TCJA limited the like-kind exchange rules under Section 1031 to exchanges of *only* real property
- Deferral under Section 1031, however, is not allowed for an exchange of real property held primarily for sale
- In addition, as under pre-enactment law, real property located in the United States is not considered like-kind to real property located outside the United States

Planning Point:* *Under 2022 final regulations, MACRS depreciation classifications have no bearing on identifying real property for section 1031 purposes. The final section 1031 regulations instead provide real property identification rules that are discrete from the MACRS classifications

- ***Real property includes "inherently permanent structures" and certain "structural components," where these determinations are made using a given list of factors***

Like-Kind Exchange Strategies

- Sell your property before identifying replacement property
- Qualified intermediary "buys" property you want before yours has sold
- Park replacement property before yours is transferred
- Acquire interest as a tenant in common
- Use a related party to accomplish exchange

Tax Trap:* *Like-kind exchange rules are very form specific and any strategy should be reviewed by your advisor before you begin to implement it

Tax Trap:* *Losses are also deferred along with gain. Can hurt you if asset values are depressed (basis exceeds value)

- ***Sell the property outright***
- ***Make sure the transfer doesn't qualify for like-kind exchange treatment (e.g., fail identification or replacement periods)***

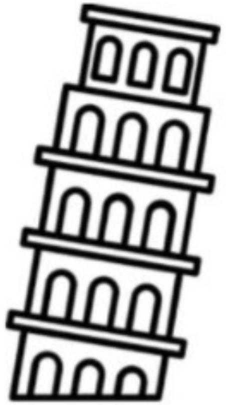
Related Party Transactions

- Definition of “related party” varies by transaction
- Usually includes:
  - Corporation and its > 50% owner
  - Partnerships and partners
  - S corporations and shareholders
  - Corporations with > 50% common ownership
  - Corporation and partnership with > 50% common ownership
  - Trusts and estates with common grantors or beneficiaries
  - Constructive stock ownership by such entities attributed to owners of such entities
  - Constructive stock ownership by an individual’s family attributed to individual

Related Party Transactions – Impact on Dispositions

- Losses on sales between related parties disallowed or deferred
- Ordinary income on sales of depreciable property instead of capital gain
- Gain recognized when property transferred in like-kind exchange is sold within two years
- Gain recognized when property sold in an installment sale is resold within two years

Why couldn't they sell the Tower of Pisa?



There was a "lien" on it

Entity Structuring and Succession Planning

Choosing the Right Entity for Your Business

Choosing the Right Business Entity

- Impact
  - Profitability and operations
  - Tax
  - Benefits
  - Risk exposure
- Types of Business Entities
  - C Corporation
  - S Corporation
  - Partnership
  - Limited Liability Company (“LLC”)

Common Entity Considerations

Pass-through taxation vs. double taxation
Flexibility to allocate tax items among owners
Flexibility to make distributions other than pro rata
Flexibility in the types of owners (*e.g.*, corporate, foreign) Flexibility in methods of providing capital
Owner participation in management
Liability protection for owners
Tax rates
20% deduction against Qualified Business Income
Treatment of liabilities for tax purposes
Type of property to be held inside entity
Ability to compensate employees with equity participation
Exit strategies
Ability to use losses
Employment tax consequences
Employee benefits
Impact of state taxes
Estate and gift taxes (*e.g.*, valuation of business interests)

Opportunities and Pitfalls – C Corporations

- Subject to “double taxation”
  - Corporate level on net profits and Shareholder level tax on dividends
- Net operating losses (NOLs) can be carried forward to offset future income
  - Under TCJA, only available to offset 80% of taxable income
- Shareholder-employees receive income from salary or dividends
  - Wages are taxed at ordinary income tax rates (currently 37% maximum) (subject to employment taxes)
  - Qualified dividends taxed at 15% / 20% (no employment tax)
- Insolvency determined at corporate level to determine eligibility for cancellation of debt rules under IRC §108

Opportunities and Pitfalls – C Corporations (cont'd)

- Subject to penalty taxes
  - Accumulated earnings tax (AET) of 20% for earnings and profits (E&P) accumulated beyond reasonable business needs
  - Personal Holding Companies (PHC) are taxed at dividend rate on undistributed PHC income
    - Refers to closely held corporations with at least 60% of income from passive sources (*e.g.*, dividends, interest, rent)
    - Exceptions: banks, financing companies

***Tax Trap:* Some companies unknowingly became PHC during a wind down phase following a reorganization or sale of assets**

Opportunities and Pitfalls – Personal Service Corporations

- Corporation performing services in fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting
- Taxed at flat 21% rate
- Subject to a “minimum distribution requirement”
- Can use cash method of accounting (C Corporation, which can only use the accrual method)
- If on accrual method, permitted to reduce accrued service income by amount that, based on experience, will not be collected

Opportunities and Pitfalls – S Corporations

- Maintain corporate form but generally subject to only one level of tax
- Special rules on eligibility, shareholder basis, distributions, and maintaining S Corp status
- S Corp can only have up to 100 shareholders and only one class of stock (can be voting or non voting)

***Tax Trap:* Certain transactions may terminate S status:**

- ***Shareholder distributions and income allocations that do not match share ownership percentages***
- ***Options and warrants to purchase common stock***
- ***Buy/sell arrangements that cause S Corp to have an ineligible shareholder***
- ***LLC taxed as S Corp does not amend LLC agreement that continues to refer to §704(b) rules***

Eligibility for S Corporation Status

Corporate Requirements	Eligible Shareholders
Must be domestic corporation	Individuals must be U.S. citizens or resident aliens
Cannot have more than 100 shareholders	Estates
Insurance companies are not eligible	Grantor trust with eligible grantor
Financial institutions cannot be on reserve method of accounting	Electing small business trust (ESBT)
	Qualified Subchapter S trust (QSST)
	Another S corporation (if sole shareholder – a “QSSS”)
	Certain tax exempt organizations
	Certain retirement plans

Opportunities and Pitfalls – S Corporations (cont'd)

- Insolvency determined at corporate level to determine eligibility for cancellation of debt rules under IRC §108
- Stock Basis and Distributions
  - Tax free distributions are allowed to extent of shareholder's stock basis
  - Shareholders must have basis in stock and loans and must be "at risk" to take advantage of pass through losses
  - Loan repayments may be taxable
  - For capital gain treatment, advances to corporation should be documented and repaid more than 12 months after loan

Tax Trap:* *If debt basis has been reduced by losses, repayment on debt will result in income unless basis has been fully restored

Opportunities and Pitfalls – S Corporation Pitfalls

- Excessive Passive Investment Income
  - If accumulated E&P and substantial “passive” income (exceeding 25% of gross receipts) prior to becoming S Corp, subject to highest corporate tax rate of 21%
  - If S Corp has net excessive passive income for 3 consecutive years, S status terminates as of first day of following year
- Built-In Gains (BIG) Tax
  - Imposes corporate level tax on gains inherent in assets held by C Corp at time it is converted to S Corp
  - Also imposed on assets acquired in certain tax deferred transactions
    - PATH Act permanently set BIG recognition period to 5 years subsequent to S election

Opportunities and Pitfalls – Partnerships & LLCs

- Pass-through tax treatment and additional flexibility
- Income allocations must have substantial economic effect
  - More flexible than S Corps which generally require pro rata allocations
- Profits interest – interest received in future profits of Partnership/LLC in return for services rendered
  - Given by partnership/LLC without requiring contribution to capital, and generally not subject to tax upon grant
  - Currently, law provides for subsequent sale by holder at capital gains tax rates

Opportunities and Pitfalls – Partnerships & LLCs

- Changes in liabilities and loss allocations may trigger income
  - IRS closely scrutinizes whether LLC liabilities should be taken into account when determining whether member is "at risk". If member is not "at risk," losses are not deductible.
  - New regulations issued recently that curtail the use of "bottom-dollar" guarantees by a partner/member on the partnership's/LLC's debt
- Partner contributions, distributions to partners and transfers of partnership interest may also trigger income and gain recognition

Planning Point: ***Tax election available to increase basis in partnership assets so that such basis is equal to buyer's investment basis (or equal to seller's gain)***

Opportunities and Pitfalls – Pass-Through Entities

- Qualified Business Income Deduction
  - Tax deferral strategies must be balanced against ability to claim new 20% deduction calculated off of Qualified Business Income
  - Need for high-level review of entity relationships, intercompany charges, and management agreements to ensure maximization of deduction

Opportunities and Pitfalls – Rental Real Estate

- “Real estate professionals” – spend more than 750 hours and more than 50% of time, and materially participate in real estate business
  - Escape limitation on passive losses
  - For material participation, each rental real estate interest generally treated as separate activity
  - May elect to treat all interests in rental real estate as single activity; election irrevocable and is permanent

***Tax Trap:* Operating businesses usually hold real estate in a separate entity. If partnership rents property to a separate business, rental income may be re-characterized from passive to active income, while rental losses remain passive losses. Lose ability to offset losses (self-rental trap).**

Opportunities and Pitfalls – Single Member LLCs

- When owned by a corporation, can be taxed as part of corporate owner or as separate corporate subsidiary
- When owned by an individual, can be taxed as sole proprietor (report as business activity on owner’s Form 1040) or as a corporation
- Disregarded entity for federal income tax unless box checked to treat separately

***Tax Trap:* Still subject to employment, excise tax, and state franchise tax obligations**

FOUR LAWS OF ACCOUNTING

1. Trial balances don't.
2. Bank reconciliations never do.
3. Working capital does not.
4. Return on investments never will.

Transition Planning and Exit Strategies

Exit Strategies

- Mergers and Acquisitions
- Noncompete, Consulting & Employment Agreements
- Business Succession Planning

Ancillary Considerations of Mergers and Acquisitions

Whether transaction costs are capitalized or deducted
Whether and to what extent tax attributes (such as losses or accounting methods) carry over
The rights of minority interest shareholders who may not want to continue with the business
The holding periods of assets or ownership interests
Restrictions caused by the involvement of related parties
The effect of the business structure or ownership on contracts, licenses and registrations
Depreciation recapture
The effects on qualified and non-qualified retirement plans or compensation

Mergers and Acquisitions - Reorganization

- Seller receives stock of Buyer instead of cash
- Qualified transactions defer taxation on sale until Seller disposes of Buyer’s stock received as part of sale price
- Entity structure impacts qualification
  - Most easily achieved with C corporations
  - Partnerships can incorporate prior to transaction
  - S corporations may lose S status

Mergers and Acquisitions – Avoid reorganization if:

- Seller is concerned about quality or marketability of Buyer’s stock
- Buyer demands step-up in basis on assets
- Buyer does not want continued involvement of Seller
- Parties want to keep transaction costs to a minimum
- Seller wants to take advantage of lower tax rates in advance of future rate increases

Noncompete/Consulting/Employment Agreements

- Consider these agreements to:
  - Protect the Buyer from the Seller competing
  - Transition knowledge and relationships from Seller to Buyer
  - Compensate Seller for the above

***Planning point:* Allocate reasonable amount of the purchase price to the agreements to prevent IRS from valuing agreements**

***Tax Trap:* IRS has subjected income from noncompete agreements to self-employment tax when parties sign one agreement for consulting and noncompete, without allocating amounts to each component**

Tax Consequences of Sales Agreements

Type of Agreement	Buyer Treatment	Seller Treatment	Employment Taxes
Consulting Agreement	Ordinary Deduction	Ordinary Income	Self-employment (S/E) tax
Employment Agreement	Ordinary Deduction	Ordinary Income	Payroll tax
Noncompete Agreement	15 year amortization	Ordinary Income	Possible S/E tax
Personal Goodwill	15 year amortization	Capital Gain	None

Business Succession Planning - Tools

- Buy/Sell Agreement
  - Locks in a buyer for a departing owner's interest
  - Fixes the method of determining the price for the interest
  - Restricts transferability of ownership interests to outside parties
  - Helps establish value for gift and estate purposes
- Life insurance
  - Provides liquidity to pay estate taxes
  - Fund purchase of decedent's ownership interest
  - Pay decedent's debts
- Employee Stock Ownership Plan (ESOP)
  - Shares sold to ESOP for benefit of employees
  - Gain deferred if invested in qualified investments

Dan Seff
Senior Managing Director
CBIZ Colorado
720.200.7000
dseff@cbiz.com