

# for the Record

## Summary of Tax Relief Measures in Response to the COVID-19 Pandemic



*The World Health Organization declared coronavirus (COVID-19) a pandemic on March 11, 2020. Since that time, the world has been profoundly altered by COVID-19. In addition to the serious effect coronavirus is having on people's health and on healthcare services, the COVID-19 pandemic is also presenting significant challenges for individuals and businesses around the globe. Below is a brief summary of the various U.S. tax relief measures that have been enacted in response to the COVID-19 pandemic, as well as tax planning opportunities to consider in responding to the changes that may be affecting your business and family.*

## CARES Act Signed Into Law; Includes Significant Tax Relief for Individuals and Businesses

Congress has passed and the President signed into law the Phase 3 COVID-19 Relief package known as the Coronavirus Aid, Relief, and Economic Security (CARES) Act, which includes a number of significant tax provisions that would affect individuals and businesses. The provisions will impact 2019 and 2020 tax returns, and present opportunities to generate tax refunds by filing amended tax returns and net operating loss (NOL) carryback claims for prior years. Taxpayers who report income tax provisions for financial statement purposes should consider how such legislative changes may affect ASC 740 reporting for the first quarter of 2020.

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## COVID-19: Tax Relief Provisions for Individuals and Businesses— Highlights of the Key Items

In response to the COVID-19 pandemic, Congress enacted massive relief packages—[The Families First Coronavirus Response Act](#) and the [CARES Act](#)—that provide significant tax relief to both individuals and businesses. We have prepared charts that summarize the significant provisions for our clients, including:

- [Individuals, Trusts & Estates](#)
- [Pass-Through Businesses](#)
- [Corporate Businesses](#)
- [Employment](#)
- [SBA Loans & Loan Forgiveness](#)

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## COVID-19 Tax Impact for Owner Operators and Their Businesses

In the turmoil being caused by COVID-19, business owners have a lot to evaluate in planning for financial success and perhaps survival, both personally and for their business. It is therefore critical that owners be aware of the provisions and ramifications of the various legislation introduced to combat this crisis so they know and understand what actions should be taken. Our level of expertise and breadth of services complement this rapidly developing and transforming environment because we see beyond the immediate issues to plan for the future. As such, we have gathered some short- and long-term planning ideas as a starting point.

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## COVID-19 Pandemic - Accounting Method Planning to Defer 2019 Income to 2020

Taxpayers should consider ways to increase cash flow in light of the challenging environment presented by the COVID-19 pandemic. One alternative is to decrease cash taxes paid through accounting method planning. Taxpayers should identify accounting method changes that can be filed for 2019 under the automatic procedure by filing Form 3115, **Application for Change in Accounting Method**. Any automatic Form 3115 must be filed by the time the 2019 tax return is due. A non-automatic change is available for 2020 and must be filed by the end of the tax year. This article provides a discussion of some of the ways accounting methods can help to decrease 2019 cash taxes.

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## COVID-19: SBA Loans and Employment Implications - Largest Fiscal Stimulus in U.S. History

In response to the COVID-19 pandemic, Congress enacted massive stimulus packages—[The Families First Coronavirus Response Act](#) and the [CARES Act](#)—that provide significant relief to employers of all sizes. Andersen has summarized these provisions in a number of charts. This [chart](#) summarizes key employer-relief provisions. Additional charts available through the link below provide detailed summaries of each relief provision. Contact us for assistance with assessing eligibility, calculating potential credits and/or deferred taxes, and specific guidance on how these provisions impact you.

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## Payroll Tax Credits Available for COVID-19 Sick and Family Paid Leave

The Families First Coronavirus Response Act (H.R. 6201), was passed by Congress and signed into law by President Trump. The legislation provides employers with a refundable Social Security tax credit equal to the amount of qualified sick leave and qualified family leave wages paid, subject to certain limitations. This [chart](#) summarizes the refundable Social Security credits, including the applicable per-day maximum amount of the credit available depending on the type of paid leave.

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## Certain Disaster Relief Payments May Be Excluded from Employee Income

Employers can provide employees with tax-free payments to reimburse them for reasonable and necessary personal, family and living expenses as a result of the COVID-19 pandemic. Such payments are fully deductible by the employer. This article provides some guidelines for ensuring any payments to employees will qualify for the income exclusion.

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## IRS FAQs Offer Further Details on July 15, 2020 Filing and Payment Deadline

IRS issued answers to [frequently asked questions](#) (FAQs) arising from the income tax return and income tax payment relief it recently announced ([Notice 2020-18](#)) in response to the COVID-19 pandemic. The Notice postpones the due date for filing income tax returns and making income tax payments from April 15, 2020, to July 15, 2020. The FAQs provide further details regarding the types of taxpayers, taxes and filings that are eligible for relief under the Notice. This article provides a summary of the key details provided in the FAQs.

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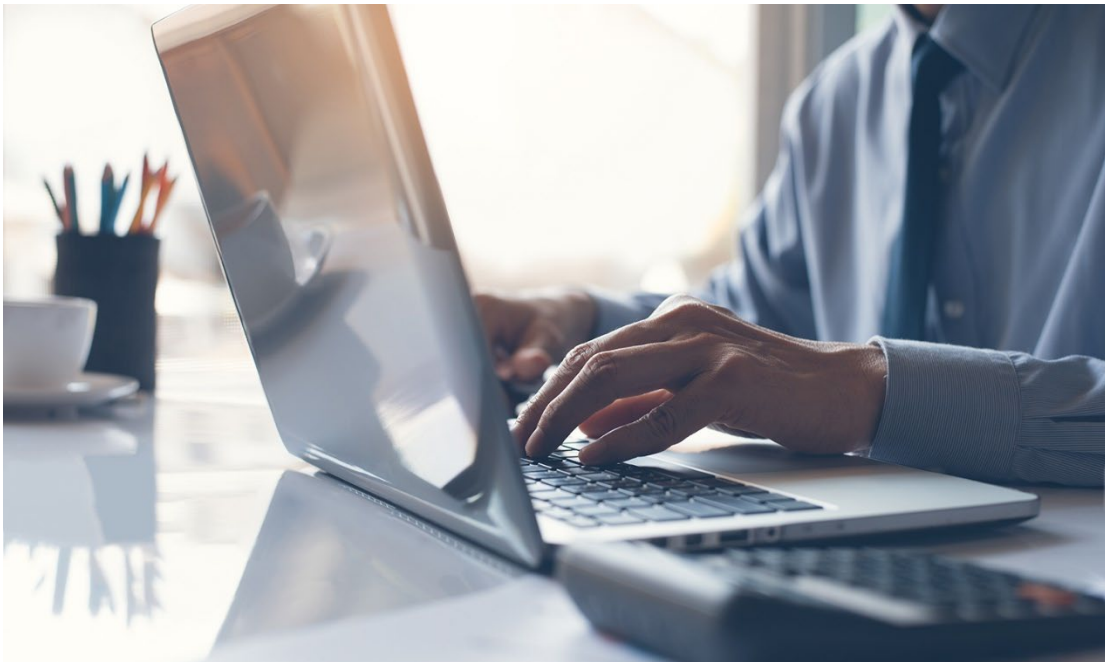
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## Lower Portfolio Volatility May Result from Following Latest Guidance on Portfolio Valuation



***In 2019, the American Institute of Certified Public Accountants (AICPA) issued guidance for investment companies on how to value their portfolio investments. This guidance may reduce the volatility of investments marked-to-market in several cases.***

### **Background**

For many investment companies, and the regulatory agencies that oversee them, the volatility of portfolio company investment values and net asset values are a top concern. Mark-to-market (MTM) refers to accounting for the fair value of an asset or liability based on the estimated market value at the date of measurement. MTM contrasts with historical cost

accounting, which maintains the value at the original historical cost. While MTM is intended to provide a more accurate picture of a company's assets and liabilities, it can result in volatility when market conditions change.

In 2019, the AICPA issued its finalized guidance titled *Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and Other Investment Companies* (the Guide). *Calibration* and *Option Pricing* are two of the concepts discussed in the Guide, and when implemented appropriately can result in more supportable valuation conclusions, but also lower volatility.

## Calibration

The Guide describes *Calibration* as the process of using observed transactions in the portfolio company's own instruments, especially the initial transaction in which the fund entered a position, to ensure that the valuation techniques employed to value the investment on subsequent measurement dates begin with assumptions that are consistent with the original observed transaction. In other words, certain valuation assumptions can be calibrated at the time of an observed transaction and rolled forward for future valuations.

Because the initial measurement often relies on the actual transaction price, rather than traditional valuation metrics such as market multiples, the implied multiple for an investment may not be known initially. For early-stage companies, the implied valuation metrics at original investment may fall outside the universe of observable data for comparable assets. For example, the implied revenue multiple may be above the universe of comparable company multiples if the investment has low revenue as it seeks to gain market traction, but growth expectations are above observable market data. Obviously, the use of market data to value the position as of subsequent dates should not trigger a write down. Without *Calibration* this may occur if a rule-of-thumb, such as the median of the universe of market data, is used.

### Calibration – Example

An investment company buys 100% of the equity of a company with \$10 million in annual revenue for 100 million. In this example, the calibrated assumptions would be as follows:

Total Company Value (\$M)	\$100
Annual Revenue (\$M)	\$10
Calibrated Revenue Multiple	10x

If *Calibration* were not considered and the median market data shows a 5x multiple, a write-down could result as follows:

	Calibrated Multiple	Median Multiple
Annual Revenue (\$M)	\$10	\$10
x Revenue Multiple	10x	5x
= Total Company Value (\$M) % of investment cost	\$100 100%	\$50 50%

In subsequent periods, if the company has grown, relying on a rule-of-thumb median multiple would be less extreme, but directionally the impact could be the same. Upon revisiting the valuation at a future period, if annual revenue has increased to \$15 million and assuming all else constant, using the calibrated multiple versus a median rule-of-thumb would yield the following:

	Calibrated Multiple	Median Multiple
Annual Revenue (\$M)	\$15	\$15
x Revenue Multiple	10x	5x
= Total Company Value (\$M) % of investment cost	\$150 150%	\$75 75%

To be used correctly, the calibrated multiple should be adjusted for changes in company and industry- or market-specific factors over time. For example, a downward adjustment could be warranted to reflect lower future growth if the company has already realized its growth potential. An offsetting upward adjustment might also be warranted to the extent certain business risks have been mitigated or resolved over time. After considering such adjustments and assuming no change in industry- or market-specific factors, the adjusted calibrated multiple might look like the following:

	Calibrated Multiple (Adjusted)
Annual Revenue (\$M)	\$15
x Revenue Multiple	8x
= Total Company Value (\$M) % of investment cost	\$120 120%

Although an extreme example for illustration purposes, this example shows directionally the impact *Calibration* can have in the valuation process. Absent *Calibration*, the value of the investment would have been incorrectly marked downward, exhibiting more variability between reporting periods with all else equal.

## Option Pricing

While *Option Pricing* is not a new concept, the Guide discusses its application specific to investment companies as opposed to the widely used *Current Value Method*. The *Current Value Method* allocates the equity value to the various equity interests in a business as though the business were sold on the measurement date, whereas *Option Pricing* is forward-looking and considers the potential for changes in business value over time. In early-stage investing, companies often have multiple classes of equity with differing preferences and seniority. Most early-stage investments will not be a home-run success, and therefore seniority and preferences can matter. In these cases, investment companies can find themselves needing to value a class of equity that sits behind a senior preferred class with a large liquidation preference that is near or even exceeds the total value of the business today. When *Option Pricing* is used, the volatility in the valuation of junior securities can be reduced.

## Option Pricing – Example

An investment company invests \$25 million for 25% of the total shares outstanding in a class of equity junior to a senior preferred class holding 75% of the remaining shares with a liquidation preference entitled to the first \$75 million of distributions (the *liquidation preference*). Ignoring participation features as well as control and marketability considerations for simplicity, assume the total equity value in a prior period was \$110 million. The following table shows the value impact to the junior equity value in each period comparing *Option Pricing* to *Current Value (Liquidation) Method* if the value were to decline over time in subsequent periods. The *Option Pricing* example uses a Black-Scholes-Merton model assuming no dividends, a three-year term, 40% total equity volatility, and a 1.5% risk-free rate.

\$ millions	Value Above Liquidation Preference	
	Option Pricing	Current Value (Liquidation)
Total Equity Value		
\$110	\$48	\$35
\$88	\$31	\$13
\$77	\$23	\$2
\$66	\$16	\$0

As illustrated in the table above, *Option Pricing* results in lower variability of the value above the liquidation preference for a given change in total company value. Additionally, there is still some value assigned to the junior equity at lower company values, whereas the *Current Value Method* indicates zero value. Using *Option Pricing* should be consistent with investor expectations and the price investors would be willing to pay for the position. If the investment company truly expects no value from the position, then a zero value could still make sense. However, in cases where the investor expects to receive proceeds from the investment, *Option Pricing* can capture this expectation and is therefore a more appropriate methodology.

## The Takeaway

Valuation inherently requires substantial judgement. Recent AICPA guidance outlines useful concepts and topics in developing more supportable valuation conclusions. In particular, *Calibration* and *Option Pricing* can help provide more supportable valuation conclusions and reduce the potential for unwarranted mark-to-market volatility.



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## The Value of Working with a Trusted Advisor and Fiduciary



*The rise in low-fee, index investing and the continued emergence of automated robo-advisors, has investors questioning whether hiring a financial advisor is a prudent decision, given the fees associated with doing so. The answer, of course, is contingent on the complexity of the individual financial situation and the investor's personal goals. According to industry studies, the value of professional financial advice can add 1.5% to 4% of return per year over the long term. The value of a trusted financial fiduciary goes beyond generating traditional alpha or excess return versus the market. These additional considerations include integrated financial planning, tax planning, portfolio monitoring, recurring plan reviews, and behavioral coaching.*



## The Financial Plan and Ongoing Planning

Many investors consider hiring an advisor based largely on their lack of knowledge or experience to self-select the best stocks, bonds, mutual funds or other financial instruments. While advisors can certainly help in this regard, investors should focus more on their own personal and financial goals when deciding if hiring an advisor makes sense. The focus of investing should not simply be to out-perform an arbitrary benchmark each year, but instead should be to ensure that that long-term personal financial goals are met. This includes utilizing the created wealth to maintain a desired lifestyle over time, achieving lasting retirement goals and sufficiently capturing the legacy left upon passing.

Advisors can help clients develop a concise list of short and long-term goals, as well as tailor their portfolio risk levels to align with those goals. Well-defined goals are instrumental in developing a complete and successful financial plan that incorporates cash flow modeling, retirement planning, and liquidity planning. Further, advisors can integrate needs for efficient estate planning, healthcare, and insurance (just to name a few other areas) into the overall financial plan. A comprehensive financial plan can also incorporate efficient methods for achieving lifetime philanthropic goals, while modeling for legacy planning to determine appropriate bequests to heirs. Wealth transfers and wealth distributions are complex and can erode a lifetime of performance if not managed early and carefully.

Critical to the planning process is the ongoing review and monitoring of the plan and of the overall goals of the investor. Circumstances change, as do the needs, goals and objectives of an investor's portfolio. Access to a trusted advisor can help investors regularly monitor their financial plan and update it during life's inflection points. Ensuring that financial plans are current, and portfolios appropriately designed are essential in reaching long-term financial goals.

## The Portfolio and Performance

After developing the overarching financial plan, investors can work with their advisor to create an investment portfolio that is tailored to their personal needs and risk tolerance. Once the appropriate asset allocation is designed, advisors help select individual managers and investments. Careful research and selection criteria ensure that the chosen investments interact appropriately to meet the portfolio's needs and can help safeguard the portfolio from the dampening effects of taxes and excess fees.

Advisors can implement customized benchmarks to measure total portfolio performance versus an index (or set of indices) and produce a concise performance report for clients to review on a regular basis. This report will help both the advisor and the investor measure the performance of underlying investments on an ongoing basis to help determine if changes are necessary. Similarly, the advisor will ensure that the portfolio is appropriately allocated to meet spending targets and advise on strategic and tactical adjustments based on market conditions.

Another significant yet often overlooked way that advisors can add value is rooted in behavioral coaching: providing support for investors to help them "stay the course" during periods of volatility and market stress. According to Russell Investments, irrationality in investment decisions eroded performance by 2% (annualized) for the average equity investor between 1984 and 2016 (33-year period). In a more current example, if you chose to liquidate your US equity allocation around the market bottom during the Great Recession in 2009, you missed out on 300% of total US equity return through 2016, based on Russell 3000 index.

## Tax Planning and Holistic Advice

Investors face significant performance erosion from taxes on investment gains and income. To combat this erosion, advisors can recommend strategies such as tax loss harvesting, where investments are sold and later repurchased (after a wash-sale period) to capture capital losses that offset other gains. This strategy reduces tax liabilities annually and, importantly, since capital losses don't expire, they can be carried forward to future years to offset future gains. Similarly, advisors can help clients efficiently realize their philanthropic goals by recommending the most tax-efficient way to give to causes that they identify with. Often, these recommendations involve donating specific highly appreciated property or stock to maximize the tax benefit of the gift but can also include strategies like establishing a donor advised fund, personal foundation or various other charitable entities.

Educating investors on estate planning techniques to reduce the burden of the estate tax on their heirs is a key component of holistic financial advice. Investors with unique and complex circumstances can benefit from the expertise of advisors who have both a deep understanding of tax law and a demonstrated insight into the investor's financial situation.

## The Takeaway

Investors can benefit significantly from comprehensive, holistic and thoughtful financial advice. Advisors can help investors refine their financial goals, design a risk-appropriate portfolio and continually monitor their comprehensive financial plan, investment portfolio, and financial decisions over time. Additionally, skilled advisors can counsel investors on complex tax and estate planning strategies that further enhance after-tax returns in both the short and long-term.



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## **An Underutilized Senior Discount: Net, Net Gifting**



*It's never too late for gift and estate tax planning, and some planning strategies can be better suited to older clients. Donors, especially older family members, who want to make substantial lifetime transfers to the next generation, can make those transfers using a technique to reduce the gift tax payable in connection with the transfer. The net, net gifting approach, which is a variation on the traditional net gift, requires the donee to assume liability for not only the gift tax attributable to the gift, but also for the contingent estate tax liability that arises if the donor dies within three years of making the gift.*

## Background

In a case from 2015, *Steinberg v. Commissioner*, the Tax Court ruled that the assumption of a potential estate tax liability may be valued actuarially, resulting in a reduction to the gift tax value and thereby reducing gift tax paid. In this case, at age 89 Mrs. Steinberg entered into a binding legal agreement with her four daughters. The agreement stipulated that Mrs. Steinberg would make taxable gifts totaling \$109.4 million to her daughters in exchange for their assumption of the payment of gift tax liability imposed as a result of the gifts, as well as payment for any federal or state estate tax liability included in her estate that resulted from these gifts in the event that she passed away within three years of making the gifts (the IRC requires that any gift tax paid on gifts made within three years of death is included in the donor's gross estate as a phantom asset)

Mrs. Steinberg reported taxable gifts equal to the value of the property gifted less the liabilities assumed by her daughters. IRS disallowed the reduction to the gifts for the daughter's assumption of the estate tax liability and issued a notice of deficiency.

## Net Gifts and the Net, Net Twist

Typically, the person giving the gift (donor) is responsible for payment of gift tax, as opposed to the person receiving the gift (donee). If the donor makes a gift subject to the condition that the donee pays the resulting gift tax, the amount of the gift is reduced by the amount of the gift tax paid by the donee. This is commonly referred to as a *net gift*, and it is the building block upon which the *net, net gift* transaction is built. Gift tax applies to transfers of property to the extent that the value of the property transferred exceeds the value of any consideration received in the exchange. In a net gift, the donor receives consideration equal to the amount of the gift tax assumed by the donee. The second "net" in a net, net gift comes into play when the donee agrees to pay any federal or state estate tax liability included in the donor's estate in the event that the donor passes away within three years of making the gift.

## The Steinberg Case

IRS disallowed the reduction to the taxable gift related to the daughters' assumption of the potential estate tax liability because, they argued, it was not consideration and has no value. IRS further contended that the value of the potential estate tax liability was too speculative to quantify. IRS accepted the premise that the gift tax assumed by the donee is consideration so that was not challenged.

The principal issue of the case was the value, if any, of the assumption of the estate tax liability. The Tax Court ruled that the daughters' assumption of the estate tax liability if Mrs. Steinberg died within three years of making the gift was consideration, and accepted the methodology used to calculate the likelihood that the daughters would have to pay this estate tax liability (i.e., the likelihood that Mrs. Steinberg would in fact die in three years from the date of the gift).

The Tax Court looked to the hypothetical willing buyer/willing seller test to determine property rights transferred and their impact on sales price, reasoning that a hypothetical buyer who assumed liabilities at the time of the sale would expect a reduction to the purchase price. The daughters' assumption of the estate tax liability was to their detriment while it was to Mrs. Steinberg's benefit. Therefore, it determined that this benefit is consideration because Mrs. Steinberg was discharged from the liability that would have otherwise reduced her estate. Further, the court accepted the methodology used to value the estate tax liability, which relied on the government's actuarial tables to estimate the likelihood that Mrs. Steinberg could pass away in each of the three years following the date of the gift, as well as the application of a government rate used for discounting to present value.

## The Takeaway

A net gift is an attractive gifting option on its own for several reasons, such as if the donor lacks liquidity or is unwilling to pay gift tax, or if the donee has liquidity to pay the gift tax. If the donor is older and wishes to make large gifts, a net, net gift could present a unique opportunity for tax savings for the family overall. Since the actuarial tables are dependent on life expectancy, the older the donor is at the time of the gift, the larger the reduction to the value of the gift will be for the donee's assumption of the potential estate tax liability. If an older donor is willing to make taxable gifts, the net, net gift transaction could be a way to further reduce estate tax and transfer more wealth to heirs.





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## Recovering Unutilized R&D Credits as a Section 196 Deduction



***Generally speaking, taxpayers cannot use federal tax credits to offset federal income tax liability if they have no taxable income. In these circumstances however, general business credits, including the federal research credit, can be carried forward for up to 20 years for use against future income tax liabilities. Despite this carryforward ability, sometimes business events occur that prevent taxpayers from realizing the benefit of these carryforward credits. C corporations may liquidate, or partnerships may dissolve or convert to corporate entities, leaving the partners with unused credits from prior years that can never be applied against tax liabilities arising from pass-through income from entities that have ceased to exist.***

***To combat this situation, taxpayers with a federal research credit carryforward that cannot be utilized may convert these credits to a deduction in the year after the credits become obsolete. However, this option is available only if they did not make the reduced credit election under Sec. 280C(c)(3) when the research credits were first claimed.***

## Background

The reduced credit election under Sec. 280C(c)(3) generally allows taxpayers to claim a smaller research credit instead of reducing their deduction for research and development expenses under Sec. 174. Most taxpayers make the Sec. 280C election because preserving the full value of the Sec. 174 deduction typically lowers federal taxable income, which may result in lower state income tax liabilities. However, taxpayers who made the election to apply up to \$250,000 of their research credit against their Federal Insurance Contributions Act (FICA) payroll tax liabilities, may have foregone the 280C election in order to maximize the value of the payroll tax offset. The Sec. 280C reduction to the credit is tied to the corporate income tax rate, so credits in 2016 and 2017 that were less than \$384,615 would have been reduced below \$250,000 if the 35% haircut was applied. Under the current corporate tax rates, credits less than \$316,456 would have been reduced below \$250,000 if a 21% haircut was applied.

Corporate taxpayers with losses at the end of the 2017 tax year might also have foregone the Sec. 280C election because the add-back of the credit to taxable income through a reduction of the Sec. 174 deduction would have reduced the net operating loss (NOL) carryforward balance so that future income would be subject to a 21% tax rate, a better outcome than taking a 35% haircut on the credit for 2017. Along with the lower tax rate, the Tax Cuts and Jobs Act (TCJA) also introduced a series of tax reforms for which taxpayers may find it desirable to forego a Sec. 280C election, including planning for Sec. 163(j), GILTI and BEAT tax minimization.

## Opportunity to Deduct Unutilized Research Credit

Section 196 allows taxpayers to claim a deduction from taxable income for any unused Sec. 38 qualified business credits in the taxable year *after* the unutilized credits become obsolete because of expiration or the taxpayer dying, in the case of individuals, or ceasing to exist in the case of entities. The list of general business credits for which Sec. 196 applies includes, among others, any research credit *not reduced by Section 280C(3)(c)*. This deduction is allowed because eligible taxpayers voluntarily reduced their Sec. 174 research and development deduction in the year the original credits were claimed, anticipating that they would be able to use the full value of the research credit claimed in a future tax year. If that opportunity never materialized due to obsolescence, Sec. 196 allows these taxpayers to recover the benefit of the Sec. 174 deduction they gave up in prior tax years.

It should be noted that the benefit is only available to unused credit carryforward balances. If taxpayers applied a portion of their research credit against FICA payroll tax liabilities, it is only the carryforward balance in excess of \$250,000 for which no Sec. 280C election was made that will benefit from the Sec. 196 deduction. Taxpayers who forego the Sec. 280C election for other reasons are not similarly restricted in pursuing the benefit of Sec. 196.

## The Takeaway

As a result of recent tax reforms, the number of taxpayers who may forego a Sec. 280C reduced credit election on their federal research credit is growing. As these businesses evolve, they may experience terminating events that allow them to claim Sec. 196 deductions. Taxpayers need to be aware of this important planning opportunity in the post-TCJA era.



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## Taking the Stretch out of IRAs: Planning after SECURE Act



*In the closing weeks of 2019, the Setting Every Community Up for Retirement Enhancement (SECURE) Act was passed by Congress and signed into law with the goal of expanding the coverage of retirement plan participation. However, in order to offset the benefits granted, it also greatly restricts some of the tax and estate planning opportunities that have been traditionally employed for individual retirement accounts (IRAs).*

### **Benefits Provided by the SECURE Act**

The SECURE Act has enacted several provisions to increase the participation and contributions to IRAs by removing the age limitation for contributions (previously 70 ½), increasing the age after which minimum distributions are required to be



made (from 70 ½ to 72), and modifying the rules around eligibility for employee sponsored retirement plans (allowing more pooled-employer plans and long-term part-time eligibility).

One of the most effective ways of obtaining savings for retirement is to start early. However, the statistics show that this has not been happening. Currently 20% of adults age 65 and older are continuing to work either full or part time. This is double the percentage of adults over 65 that were still working as of 1985. By removing the age limitation for deducting an IRA contribution, Congress is acknowledging those adults still working, and allows them to continue to make contributions to their IRAs. Additionally, by delaying the required minimum distributions, those still working can continue to grow the money in their IRA.

## **Qualified Charitable Distributions**

Along with the above pro-taxpayer provisions, the SECURE Act only tangentially impacts planning with Qualified Charitable Distributions (QCD's). A taxpayer receiving required minimum distributions may designate up to \$100,000 of such annual distributions to charity and exclude that amount of the distribution from their taxable income. While this is still allowable, the SECURE Act did modify this to be offset by any contributions made to the IRA after attaining age 70 ½. A taxpayer cannot get both the exclusion of the QCD and the deduction for contributing to the IRA in the same year.

## **Offsets to Pay for SECURE Act Benefits**

The Congressional Budget Office (CBO) estimates that the changes made to incentivize retirement savings will reduce tax revenues by \$15 billion over a 10-year period. In order to offset that lost revenue, the SECURE Act is modifying the rules around inherited IRAs. A common planning tool known as *Stretch IRAs* allowed for lengthy deferral of retirement savings; however, the SECURE Act has eliminated the *Stretch IRA*. The CBO predicts this one change will increase tax revenue by \$15 billion over that same 10-year period to entirely offset the beneficial changes. However, in doing so, it is upending already established planning.

Previously, if structured properly, retirement assets left to children or grandchildren could be distributed over the child's or grandchild's expected lifetime. The younger the beneficiary, the longer the tax deferral. This strategy received a lot of press during the 2012 election season when it was noted that Mitt Romney's IRA assets were a shocking \$102 million. Under the previous rules, these assets could be left to a beneficiary and have a lengthy deferral.

While there are exceptions for surviving spouses, chronically ill individuals, and children under the age of 18, the SECURE Act removes the potential benefits by shortening the distribution period (and therefore income tax deferral period) from the lifetime of the beneficiary to a 10-year period for an individual dying after December 31, 2019.

Along with the obvious income tax impact, this change could also disrupt a lot of already established plans. Beneficiaries who are inheriting an IRA through other tax planning vehicles like trusts will have to reexamine the terms of those vehicles. Many trusts have stipulations about the allowable withdrawal amounts (minimum and maximum payouts), which can create conflict with the new tax burdens and payout schedules from the 10-year payout period. This acceleration of payments can move the tax payouts to peak earning years of the beneficiary where their marginal rates are quite high. Additionally, the new payment schedule may conflict with the desire to not distribute assets to children over a short period of time.

## **Income and Estate Planning Alternatives**

Taxpayers will want to review the current plans for their IRAs to understand the impact of the new law and consider the alternative options. If the current beneficiaries are trusts, children, or grandchildren, the new 10-year distribution period will likely have an impact on their goals. Whether the goal is to structure a specific distribution schedule, defer the tax liability on assets, minimize the eventual tax rates, or donate a portion to charitable organizations, there are different options available.

### **Charitable Remainder Trusts**

One option is to designate a Charitable Remainder Trust (CRT) as the IRA's beneficiary. A CRT allows for a payment structure over the life of a child or children (or term not to exceed 20 years) with the remaining portion of the assets being left to a charitable organization. Distributions from a CRT to the child can be established as either an annuity of a fixed amount or fixed percentage of the fair market value of the assets and act as a replacement for the former stretch distributions.

The maximum value of the distributions is determined on an actuarial basis so the expected value to be remaining and left to a charity is at least 10% of the initial value of the transferred assets. However, the ultimate amount left to the charity may be higher or lower depending on the actual performance of investments and the timing of a beneficiary's death compared to life expectancy.

### Insurance Trusts

A second planning option is to use distributed IRA funds to establish a trust that purchases a Life Insurance Policy. The insurance trust would have flexibility in scheduling the distributions to beneficiaries of the eventual insurance proceeds. While the IRA distribution would create an upfront tax, the insurance proceeds could be exempt from the estate tax if structured properly. Of course, this is a more complicated structure and the individual would need at least some appetite for insurance.

### Roth Conversions

Finally, the current low personal income tax rates have increased the attractiveness of converting a Traditional IRA into a Roth IRA. The cost of recognizing the taxable income upon conversion at the owner's current tax rates may be preferable to the beneficiary recognizing the distributions at a higher rate during their peak earning years under the new 10-year distribution period. In addition, for estate tax purposes, the owner of the IRA would be reducing his or her estate by paying the tax on the conversion rather than having the beneficiaries pay the tax under the new accelerated distribution rules. This conversion would have to be modeled to determine the timing, tax impact and benefits. Similar to the initial traditional IRA, the inherited Roth IRA would still be subject to a 10-year distribution for the beneficiary.

### **The Takeaway**

The SECURE Act's aim to increase the participation and contributions to IRAs will likely have a positive impact to some. However, in order to pay for the benefits in the SECURE Act, some income and estate planning benefits have been reduced. Taxpayers impacted by an offset should revisit their current plans and consider the planning alternatives.



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