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Year in Review: Planning Ideas to Consider for Year End 2021 and Beyond

Year-end planning is important but doing so requires navigating various temporary and proposed tax changes. While it is difficult to predict at this point whether and when tax law changes may occur, there are still a number of strategies that taxpayers may want to consider despite the legislative uncertainty. To that end, below are a number of tax planning opportunities for individual and business taxpayers to bear in mind for year end and beyond.

- ***Year-end Planning for Individuals***
- ***Year-end Planning for Businesses***

Andersen continues to monitor pending legislation and will keep you informed regarding other potential tax planning strategies that may be triggered by such developments. For the

latest on possible legislative tax changes, see Andersen's [Tax Policy and Legislative Updates] page.

INDIVIDUALS

Proposed Surtax on High-Income Individuals

Among the provisions included in the Build Back Better Act passed by the U.S. House of Representatives is a 5% surtax on modified adjusted gross income (AGI) above $10 million ($200,000 for an estate or trust) and an additional 3% surtax (for a total surtax of 8%) on income above $25 million ($500,000 for an estate or trust). The surcharge would take effect for taxable years beginning after December 31, 2021.

The surtax could represent a major tax increase for taxpayers who are charitably inclined because it applies to AGI, which is AGI reduced for investment interest expense deductions, but not reduced for charitable deductions. Further, the thresholds for trusts are such that the highest rate will apply for many trusts. In anticipation of the potential enactment of the new surtax, affected individuals should consider accelerating income in 2021. This may be accomplished by taking actions such as exercising nonqualified stock options in 2021.

For a summary of other potential legislative changes to discuss with your tax advisor, please see Andersen's 2021 Legislative Updates.

Charitable Donations

The Consolidated Appropriations Act, 2021 extends the temporary AGI limit increase on charitable deductions for cash gifts to a public charity for individuals through 2021 to 100% of AGI. The AGI limit was initially raised for the 2020 tax year from 60% under the Coronavirus Aid, Relief, and Economic Security (CARES) Act in 2020. As under the CARES Act, the 100% limit does not apply to contributions to a donor-advised fund or a Sec. 509(a)(3) supporting organization. This temporary suspension of the limitation will expire at the end of 2021 and presents significant opportunities for individual donors and private foundations. For more information on the extension of the temporary AGI limit increase on charitable deductions and other changes enacted by the Consolidated Appropriations Act, 2021 please see COVID-19 Relief Bill Allows Deductions of Expenses Paid with Forgiven PPP Loans, Makes Business Meals Fully Deductible, Extends Credits.

Interest Costs

Individuals seeking to lower their federal and state tax liabilities may want to consider opportunities to save based on the deductibility of interest costs. The tax treatment of interest on personal debt depends on the category of interest. Therefore, how loans are structured can have a significant impact on an individual's tax liabilities, as well as cash flow and borrowing costs. For more information see Andersen's White Paper – Strategic Borrowing for Individuals: Maximizing Deductible Interest Expense to Minimize Liability.

State Pass-Through Entity Taxation

The TCJA imposed a $10,000 cap on state and local tax deductions on individual income tax returns. In response, many states created an optional tax, letting owners of pass-through entities—where income flows through and is taxed at the ownership level—circumvent the $10,000 limit on deductions. IRS released guidance in late 2020 confirming that state and local income taxes imposed on and paid by a partnership or S corporation are allowed as a tax deduction. However, there are important issues that should be considered before a taxpayer makes a pass-through entity election. For more information see Andersen's State Pass-Through Entity Laws – Developments To Date And Looking To The Future.

Estate and Gift Planning

The Build Back Better Act removed the provision from earlier proposed legislation that would have reduced in half the gift, estate and GST exemptions by year-end. Despite this apparent reprieve that would maintain exemption amounts as is (including indexing for inflation) until January 1, 2026, it is nonetheless still advisable for many individuals to use their exemptions now. Due to concerns of a significantly reduced exemption, many people already began planning for wealth transfers. From a practical perspective, it would be more efficient to complete those transfers now rather than wait and have to start over with those discussion as we get close to year-end 2025. More importantly, as time goes on, the likelihood is that assets will continue to grow over the next few years. Without planning, that growth will occur in an individual's estate rather that outside the estate and planning benefits will be reduced. The one caveat being that if riskier transactions were considered because individuals wanted to use all of their exemption but did not have the overall wealth such that they could give up any access to such wealth, those transactions should likely be reconsidered.

BUSINESSES

Corporate Book Minimum Tax

The Build Back Better Act passed by the U.S. House of Representatives on November 19, 2021, includes a corporate book minimum tax which would impose a 15% minimum tax on the corporate profits of large corporations with over $1 billion in book profits for taxable years beginning after 2022. The House proposal is consistent with the proposal recently released by a group of Democratic senators.

For a summary of other potential legislative changes to discuss with your tax advisor, please see Andersen's 2021 Legislative Updates.

Accounting Methods – Income Recognition Rules

Final regulations for Sec. 451(b) and (c) enacted under the TCJA were released in early 2021. The final regulations provide more favorable rules than prior proposed guidance and may provide opportunities for taxpayers to defer or reduce revenue recognition for 2021 (though consideration should be given to increasing revenue in 2021 if the corporate tax rate is expected to increase in 2022). The regulations are effective for taxable years beginning on or after January 1, 2021. For more information, see Andersen's Tax Release – Treasury and IRS Issue Final Income Recognition Rules Under TCJA.

Business Meals Deduction

The Taxpayer Certainty and Disaster Relief Act of 2020 temporarily increases the deduction for food and beverages purchased by businesses from restaurants from January 1, 2021 through December 31, 2022 to 100% (up from 50%). Notice 2021-25 describes the requirements businesses must satisfy to qualify for the temporary 100% deduction. The increased tax deduction translates into a lesser impact on a company's effective tax rate. For more information on deducting meal and entertainment expenses see Andersen's Deductibility of Common Meal and Entertainment Expenses.

Research Credits

Tucked within the sweeping Tax Cuts and Jobs Act of 2017 (TCJA) was a change to the treatment of research and experimental (R&E) expenses under Sec. 174 of the Internal Revenue Code. Currently, taxpayers can elect to immediately expense such costs. However, beginning January 1, 2022, the TCJA requires taxpayers to capitalize previously deductible R&E expenses. The TCJA provides a ratable amortization period of five years for R&E conducted in the United States and 15 years for non-U.S. activity beginning at the midpoint of the tax year incurred. The proposed Build Back Better Act would defer research capitalization to 2026. For more information, see Andersen's White Paper – With the Ability to Expense Research and Experimental Costs Ending After 2021 – Now Is the Time to Prepare to Capitalize R&E.

Lease Modifications

In response to the COVID-19 pandemic and resulting downturn, many taxpayers are revising and renegotiating their contractual obligations, particularly for leases of real estate, business facilities, office space and equipment. However, the parties may be unaware that the lease agreement modifications may have potentially significant tax consequences. When negotiating a lease modification, the landlord and tenant have the flexibility to write the modified agreement any way they see fit in regards to when rent accrues and when it is payable. This flexibility can allow the parties to use lease modifications to obtain a particular tax result or treatment. It is also important to review all lease modification to be sure rental income or rental deductions are reflected in the correct tax period. For more information see Andersen's White Paper – Think Before You Move – The Tax Planning Opportunities and Consequences of Lease Modifications.

Mergers and Acquisitions

As with any merger, acquisition or internal restructuring, there are a myriad of tax and non-tax matters that must be addressed. One often overlooked area where cash and employee satisfaction value are hidden is in payroll taxes. Andersen's team of experienced employment tax specialists can help to identify potential refund opportunities and prevent the over withholding of employment taxes. For more information see Andersen's White Paper – Mergers & Acquisitions: Identifying and Maximizing Payroll Refund Opportunities.

Companies often pay substantial transaction costs when acquiring or selling a business. Fees paid to investment bankers, lawyers, accountants and consultants to implement a transaction may be deductible for federal income tax purposes depending on the nature and timing of the services. Andersen can help companies engaged in a merger or acquisition (M&A) reduce their overall tax liability by performing a transaction cost study aimed at identifying costs that can be immediately deducted or amortized. Even if a company has net operating losses (NOLs), a study may be valuable to avoid a situation where otherwise deductible costs are permanently capitalized and cannot be recovered except in very limited circumstances. For more information see Andersen's White Paper – M&A Tax Services – Are Your Transaction Costs Deductible?

State Taxes

As the COVID-19 pandemic and work-from-home arrangements continue, state and local jurisdictions are ending the temporary tax relief granted in 2020 for employees working in their jurisdiction. An employer with remote employees that fails to adjust to this change could face significant tax liabilities. Below is a discussion of the temporary policies and their expiration dates in Pennsylvania, Philadelphia, New Jersey, Delaware, New Hampshire and Massachusetts. For more information see Andersen's Tax Release – States End COVID-19 Tax Relief as Pandemic and Work-From-Home Arrangements Continue, Creating Liability Risks for Employers.

Businesses routinely submit to audits by state and local taxing jurisdictions aimed at identifying and collecting underpayments of sales and use taxes or gross receipts taxes. However, a more proactive approach is necessary to identify overpayments of tax or when tax is being paid on one or more exempt or excluded items. These types of errors can be uncovered by performing a reverse audit. The result is often the discovery of refund opportunities, which can generate income and create positive cash flow. There are numerous reasons that contribute to companies overpaying sales and use and gross receipts taxes. Below is a discussion of how a reverse audit can assist companies in finding refunds and improving their compliance systems. For more information see Andersen's Tax Release – How to Leverage a Reverse Audit to Uncover Tax Refunds, Identify Areas of Exposure and Improve Compliance Systems

few market indications available to substantiate values. It is more important than ever to seek assistance from an appraiser who can thoroughly analyze and support your fair market value estimates.

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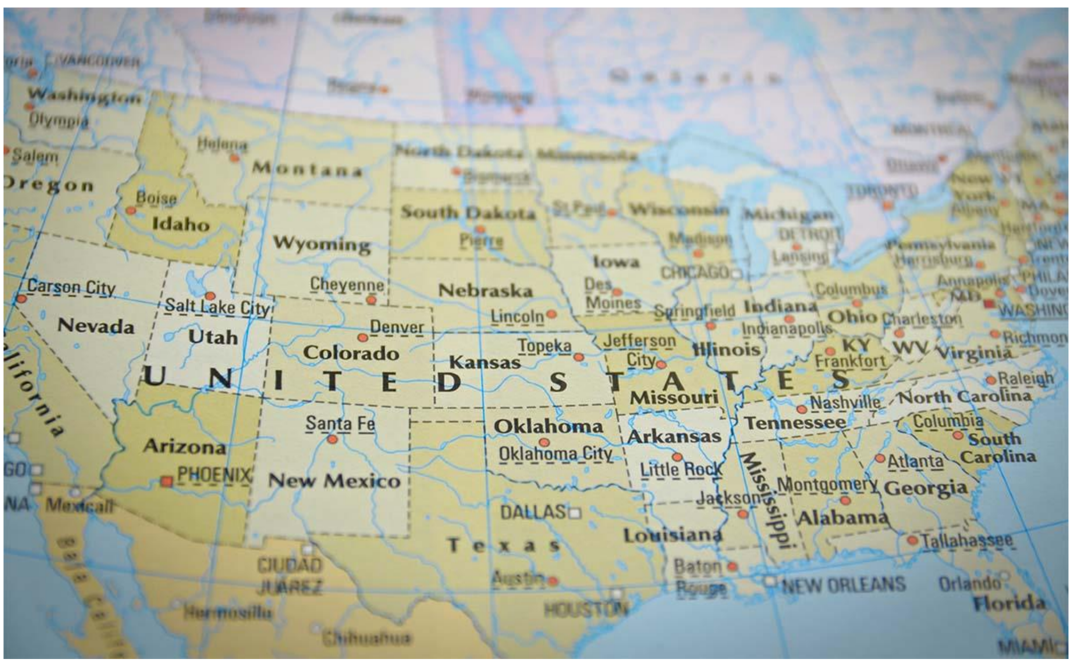
State Pass-Through Entity Laws – Developments to Date and Looking to the Future



Since the federal income tax was first passed, taxes paid to states and localities have been fully deductible against a taxpayer's federal income tax. When the Tax Cuts and Jobs Act (TCJA) was being debated in 2017, its drafters focused on this deduction as way to raise revenue without raising tax rates, and limited the deduction for state and local income and property taxes to $10,000.

By virtue of how different state's levy taxes, this change to the tax code didn't impact all taxpayers equally. Taxpayers from states with high state income taxes would lose a significant deduction. Conversely, taxpayers living in states with no income tax would only lose property tax deductions over the $10,000 limit.

The Origin of State Pass-Through Entity Laws

From the moment the TCJA was passed, taxpayers, lobbyists, and state legislators looked for ways to restore this deduction. Early ideas ranged from recasting state taxes as "charitable donations" (an idea shot down almost immediately by IRS) to allowing employers pay the state tax for their employees and granting the employee a credit. (This New York program still exists, but what evidence is available suggests that very few employers are interested.) Eventually, Connecticut settled on the idea of requiring pass-through entities (entities which don't themselves pay taxes; instead, income is "passed through" to their owners who are then taxed directly on that income). The state law then grants the owner a state tax credit for most of the taxes paid on the owner's behalf to prevent double-taxation at the state level. The owner correspondingly gets an uncapped deduction for federal tax purposes for the tax paid by the entity.

As other states began to take steps towards similar laws, IRS issued guidance (IRS Notice 2020-75) which confirmed that this strategy was viable. The notice laid down broad guidelines for similar laws and provided notice of forthcoming related regulations. In the year since this IRS notice, 19 more states have followed and introduced pass-through entity tax legislation, with others still considering such measures. While the general contours are the same for all of them, they differ in some important specifics.

State-Level Nuances

No other state has followed Connecticut in one significant aspect; the Connecticut law is mandatory. Every other state that has passed a pass-through entity tax has made the tax an election on the part of the entity. States also differ as to eligibility rules. California, for example, does not allow a partnership to make this election if any of its partners are themselves partnerships or disregarded business entities (such as a single member LLC). In other states, it's unclear if trusts are eligible partners.

There are other state-level nuances to consider as well. The date by which an election must be made differs between states, and what steps a partnership must take to make the election also varies. Using California as an example again, in that state the partnership makes an election, but then each partner must also elect individually to participate. How states source income, how they treat part-year residents, and how they handle estimated tax payments all differ from state to state, and how each state treats those issues impact the pass-through tax.

That there are twenty states which have pass-through entity tax laws means there are still thirty states that don't have such laws. Multistate taxpayers face the additional issue of identifying whether or not their home state will give a credit for taxes paid to another state on the taxpayer's behalf by pass-through entities. In most states, the existing laws on out-of-state tax credits predate this issue, and it is rarely clear whether and how they can be applied to pass-through entity taxes. Few state revenue departments have issued guidance on this issue. Most states' laws only grant a credit for a tax paid to another state which are levied "on the individual," which would seem to disallow many pass-through entity taxes. For example, a recent Maine Supreme Court decision firmly disallowed such a credit for Connecticut taxes paid on a Maine taxpayer's behalf because the Connecticut tax is imposed on the entity, not the individual. Even states with a pass-through entity tax of their own won't necessarily grant a credit for all other states with similar credits – it's important to know the specific wording of each law.

The Takeaway

The House of Representatives' version of the Build Back Better Act, passed in the House on November 18, 2021, raises the State and Local Tax (SALT) cap from $10,000 to $80,000. Although news out of the Senate suggests that the House proposal is unlikely to make it through with that precise number intact, this provision is a bargaining chip to bring on board congresspeople from states with high income and property tax rates. Any of the various options currently being discussed would make it so that almost all middle-income taxpayers (and many higher-income taxpayers) get a deduction on the full amount of SALT taxes paid. If this provision eventually becomes law, it remains to be seen whether or not it will ease the pressure on states to continue pushing forward pass-through laws. Such legislation may also have an impact on some states whose already-passed laws contain provisions which were written to trigger on the "repeal" of the SALT cap, but which might be broadly-worded enough to include this significant change in the limitation.

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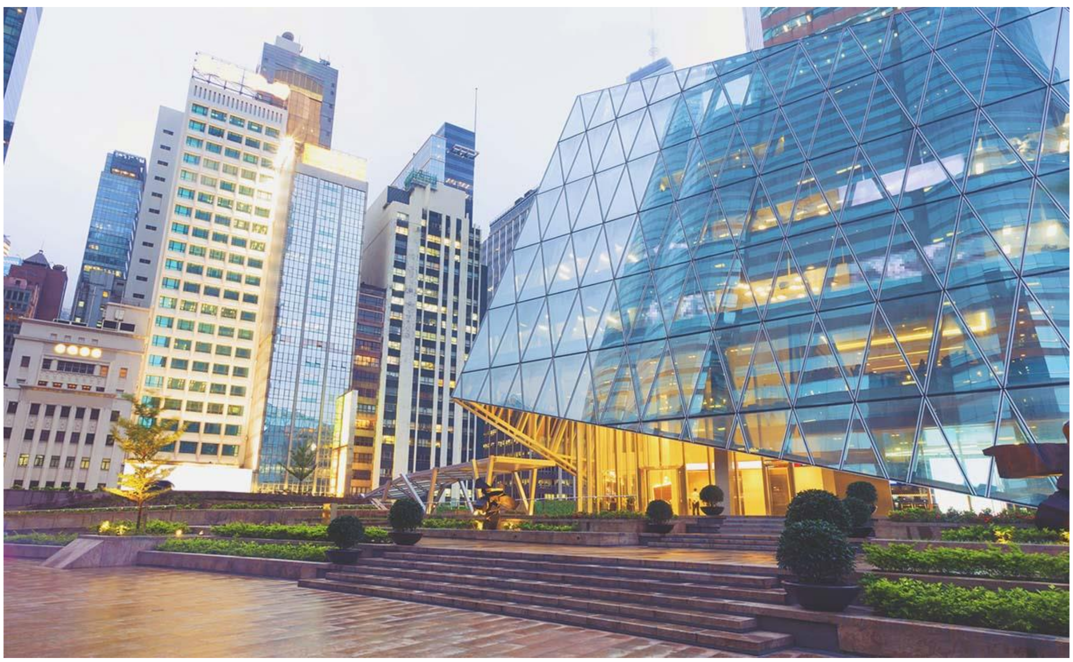
Avoid Purchase Price Allocation Disputes and IRS Controversy



Taxpayers that purchase or sell a business must report how the purchase price paid is allocated amongst the transferred assets. Adding complication to this requirement is that buyers and sellers often have competing interests in how the purchase price is allocated to fixed and intangible assets. Internal Revenue Service (IRS) has recently announced compliance initiatives to ensure consistent reporting from buyers and sellers. Taxpayers should carefully consider options to appropriately address purchase price allocation consistency and reporting.

Background

Taxpayers party to a purchase of assets constituting a trade or business in a taxable transaction are required to allocate the purchase price between the assets based on relative fair market value. This exercise may seem straightforward. However, competing interests between buyers and sellers, lack of specificity in the negotiations and transaction documents, and recent IRS initiatives to ensure taxpayer consistency highlight the necessity of carefully navigating this matter. Therefore, it is more important than ever for buyers and sellers to agree to the allocation methodology and report transactions consistently.

Determining fair market value can be subjective and sensitive to the underlying valuation approach. Parties to the transaction often have adverse tax interests in the results of the allocation. Buyers typically prefer a greater allocation to fixed assets that can often be immediately expensed (or depreciated over a shorter period) rather than intangible assets or goodwill that are typically amortized over a 15-year period. Conversely, sellers generally favor a greater allocation to goodwill which generates long-term capital gain, rather than fixed assets potentially subject to ordinary income from depreciation recapture.

Asset purchase agreements often contain elaborate dispute resolution provisions in the event buyer and seller cannot agree on the purchase price allocation. Taxpayers have at times dealt with the issue by “agreeing to disagree” on the allocation, ultimately taking inconsistent positions for tax reporting purposes that each party believes it could defend as representative of fair market value if challenged.

Beginning in 1988, the purchase price allocation has been a required disclosure on special forms filed with a tax return where the counterparty to the transaction is identified. This requirement provides IRS with the ability to identify situations where parties have taken inconsistent allocation positions. In practice however, IRS has rarely raised the issue of inconsistent allocations on examination and has generally not emphasized consistent reporting of the transaction by both parties. This lack of emphasis appears to have changed, as earlier in 2021 IRS announced an enforcement campaign to address taxpayers not filing required forms or taking inconsistent reporting positions.

Impact of Consistency

While IRS is not bound by allocations agreed amongst the parties, it has generally been less likely to challenge allocations where parties have a binding agreement to use consistent allocations, particularly where the taxpayers have adverse interests in the outcome. Considering the enforcement campaign, taxpayers are incentivized to proactively resolve the allocation issues amongst themselves as part of the deal negotiation.

Approach by Taxpayers

Even after counterparties negotiate resolution to adverse interests, practical difficulty exists in attempting to determine a fair market value allocation at the time the transaction is executed. For example, the parties typically do not have final closing financial statements or cannot perform a reasonable appraisal (or timely engage a third-party valuation specialist) for assets where book value is not an adequate proxy for fair market value.

Parties often negotiate for a reasonable period following closing, typically 90 to 120 days, to agree upon an allocation. As a best practice to facilitate ease of reaching a conclusion, the purchase agreement should establish clear parameters around how the final values should be determined to minimize potential disagreements after closing. Such granularity could include nominating an independent third-party appraiser, identifying specific valuation methodologies that will be employed, or even identifying parameters and principles that will be used to value different categories of assets, such as aligning the valuation of accounts receivable or deferred revenue with the values assigned for working capital or indebtedness computations in determining the final purchase price.

Addressing Remaining Inherent Differences in Reporting

There is a misconception that agreement on the allocation means that each party's IRS forms must be identical. Even where allocations are agreed by the parties, there are normally differences in the amounts reported on IRS forms due to the nature in which each party calculates its respective "consideration" to be allocated. For example, a seller may be required to report certain contingent consideration on the closing date (even when not yet paid during the tax year) whereas a buyer may not be able to report such amount until actually paid. Moreover, a buyer will include its capitalized transaction costs as part of the consideration allocated, while such costs are not relevant to the seller's reporting. Accordingly, well documented workpapers should be maintained to explain and reconcile such differences in case of audit.

The Takeaway

To proactively address potential controversy between buyer, seller and IRS, taxpayers party to an asset acquisition should include provisions in the purchase agreement specifying the methodology for the purchase price allocation and include a reasonable period of time following closing to agree on the specific dollar amounts allocated to each category of assets. Purchase agreements should also contain an exhibit to the purchase price allocation provision defining the valuation parameters in as detailed a manner as possible. Finally, taxpayers should maintain robust supporting workpapers that reconcile amounts reported on IRS forms to the purchase agreement and its supporting exhibits in case of IRS inquiry.

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Year-End Tax Planning Considerations for Global Mobility

Closing another year of the COVID-19 pandemic leaves many facing a second year of global tax challenges due to the complexities of multi-jurisdictional compliance for remote workers. Planning for global compliance is especially important as work locations continue to be in flux and businesses strive to mitigate the tax risks stemming from remote work. With several benefits to having a global workforce, many employers and employees believe remote work is here for the long term. However, having a remote workforce requires companies to appropriately strategize and develop policies which reflect the corporate philosophy and risk profile. As companies grapple with what type of strategy works best for their business, beyond year end and into the new year, remote work and global mobility will need to be evaluated to accommodate this ever-changing environment.

Tax Planning When Considering a Remote or Global Workforce

Leaping from established work locations to anywhere with a Wi-Fi connection can impact more than just the employee. The implications of remote work can affect tax, immigration, employment law, and/or mobility planning. Whether an employee is temporarily or permanently relocating, travel can trigger a multitude of compliance issues for the business (and the employee). Working across states or international borders brings into play compliance requirements in each of those jurisdictions. With any type of business travel or relocation, along with other implications, it is necessary to evaluate possible tax and payroll obligations.

If not already addressed, then at year end it is important to know where your employees are and have been during the year. This information is critical to ensure correct reporting within each jurisdiction and minimize penalties for noncompliance.

Covering Year-End Compliance for Global Mobility

There are a variety of payroll compliance considerations for year end, keeping in mind reportable wages (by location), such as base wages, equity, bonuses, 401K deductions, medical and dental deductions. If you oversee a global mobility program or have people deployed remotely as part of a business strategy, you may also need to consider allowances paid which relate to the employee's work location. Examples include moving (household goods, shipping, airfare), housing, cost of living adjustment (COLA), temporary living expenses, home leave, and auto allowances. Other benefit offerings to account for may include hypothetical tax deductions, tax equalization settlement payments, home and host country income and social taxes paid by the company, and tax gross-ups. Specific to COVID-19, other expenses to consider that may have been paid in the last year for remote employees are travel, temporary living, workspace improvement, and teleworking expenses.

Tax Planning for Global Mobility Goes Beyond Year End

Year-end planning can highlight the need for corporate policies. Global mobility, remote work, business traveler, and tax equalization policies are all key in setting up the company for success. These policies reflect the corporate philosophy, what an employee can expect, and protect the company from ambiguity. A yearly review of remote work and global assignment policies should take place to get ahead of potential updates to overall guidelines.

For example, reporting requirements will vary depending on the jurisdictions/countries touched during an assignment or where employees have been relocated. It is critical to have a tax provider with knowledge of the specific laws in those locations to ensure proper compliance.

Another area that can provide tax savings is a close review of moving expenses. Although majority of these expenses are taxable in the US for federal purposes, they are not taxable in many states, and most countries also do not tax household goods moves or airfare for relocations. A close review of these expenses, including timing of payments, can result in significant tax gross up savings.

One other way to simplify year-end tax planning is to account for any relocation or taxable benefits for employees periodically, on a quarterly or monthly basis. This will bring the company in line with payroll compliance.

The Takeaway

Businesses can aim to reduce tax issues by keeping in mind considerations for a remote or global workforce. During the year-end process, remember that having an appropriate corporate policy in place, along with administering periodic expense reviews, can ensure tax planning goes smoothly. To ensure your business remains globally compliant, it is recommended that you consult an advisor experienced with these specific issues.

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