rkl

2022

Year-End Tax Planning Guide

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Welcome to RKL's
2022 Year-End Tax Planning Guide

New laws, a global pandemic, deadline extensions, inflation, international conflict and more — there's been a lot of change and upheaval in recent years. Through it all, the RKL team stayed focused on ways to maximize your tax position, seize current opportunities and lay the groundwork for a more profitable future.

Each year, through the RKL tax guide, we reinforce perennial guidance and highlight lesser-known strategies and tactics to help you finish the year strong and get well-positioned to take on the next challenge. As you review the provisions in this publication, contact your RKL advisor or the specialty practice leaders listed throughout to discuss concepts further and review applicability to your own situation.

As always, thank you for trusting us to help you, your family and your business navigate current challenges and get future-ready. Stay connected with us via **LinkedIn** and our **monthly e-news** to get the latest updates and analysis from the RKL team.

WENDY L. LANCE, CPA, MST
Partner & Leader | Tax Services Group

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Quick Guide:
2022 Tax Year Figures & Filings

Standard Deduction

Married Filing Jointly	$25,900
Single	$12,950
Head of Household	$19,400
Married Filing Separately	$12,950

IRA Contribution (Traditional & Roth)

$6,000, with additional $1,000 catchup age 50 or over

Federal Estate Tax

40% (maximum rate)

Annual Gift Tax Exclusions

$16,000 or $32,000 if gift-splitting with spouse

(must be used by December 31 with no carry-over)

Health Savings Account (HSA) Contribution (employer+employee)

Self-Only	$3,650
Family	$7,300

REMINDER

Balance of deferred payroll tax deposits (employer's portion or self-employed individual equivalent) is due **December 31, 2022.**

Deadlines for Key 2022 Tax Filings

Tax Type	Due Date (for calendar year entities)
Partnerships (Form 1065) S Corporations (Form 1120S)	March 15, 2023
Individuals (Form 1040), C Corporations (Form 1120), Foreign Bank and Financial Reporting Form (FBAR) FinCEN Report 114 and Trusts and Estates (Form 1041)	April 18, 2023
Tax-exempt nonprofit organizations (Form 990)	May 15, 2023
Extended return filing for Partnerships (Form 1065) & S Corporations (Form 1120S)	September 15, 2023
Extended return filing for Trusts and estates (Form 1041)	October 2, 2023
Extended return filing for Individuals (Form 1040), Foreign Financial Reporting (FBAR) & C Corporations (Form 1120)	October 16, 2023
Extended return filing for Tax-exempt Nonprofit Organizations (Form 990)	November 15, 2023

Individual **Tax**

IRS Features and Self-Service Options

REQUEST AN IP PIN

An Identity Protection (IP) PIN is a six-digit number that verifies your identity and prevents someone else from filing a tax return using your Social Security number. Taxpayers may voluntarily opt into the IP PIN program to protect themselves from tax-related identify theft, but there is no opt-out method once enrolled. **Learn more: IRS.gov/getanippin.**

RETRIEVE YOUR IP PIN

Once you've opted in, the IRS generates a new one every year for added security. The new IP PIN will be displayed in your IRS account, or call the IRS at 800-908-4490 for specialized assistance.

USE MY IRS PAGE TO PAY TAXES, REVIEW PAYMENTS AND MORE

The My IRS page (**irs.gov/payments/view-your-tax-account**) allows taxpayers to create an account to make payments, keep track of upcoming payments and track payment history. This site is updated regularly so taxpayers can view key information from their most recent tax returns.

WHERE'S MY REFUND?

Taxpayers can view refunds and track progress and status at **irs.gov/refunds**.

REQUEST TRANSCRIPTS

Taxpayers may request electronic or hard copy transcripts of their tax returns via **irs.gov/get-transcript**.

PA Tax Self-Service Options

MANAGE PA TAX FILINGS

Use the **myPATH.pa.gov** portal to file returns, pay taxes, check estimates and complete other services.

NEW FOR 2022

Effective January 1, 2022, Pennsylvania personal income tax payments of $15,000 or more must be made electronically (via credit/debit card or ACH bank transfer). Payments not made electronically will be subject to a three percent penalty (not to exceed $500).

2022 Personal Income Tax Rates & Brackets

Rate	Single	Head of Household	Married Filing Jointly	Married Filing Separately
10%	$0 to $10,275	$0 to $14,650	$0 to $20,550	$0 to $10,275
	Tax Owed 10% of taxable income	**Tax Owed** 10% of taxable income	**Tax Owed** 10% of taxable income	**Tax Owed** 10% of taxable income
12%	$10,276 to $41,775	$14,651 to $55,900	$20,551 to $83,550	$10,276 to $41,775
	Tax Owed $1,027.50 plus 12% of the excess over $10,275	**Tax Owed** $1,465 plus 12% of the excess over $14,650	**Tax Owed** $2,055 plus 12% of the excess over $20,550	**Tax Owed** $1,027.50 plus 12% of the excess over $10,275
22%	$41,776 to $89,075	$55,901 to $89,050	$83,551 to $178,150	$41,776 to $89,075
	Tax Owed $4,807.50 plus 22% of the excess over $41,775	**Tax Owed** $6,415 plus 22% of the excess over $55,900	**Tax Owed** $9,615 plus 22% of the excess over $83,550	**Tax Owed** $4,807.50 plus 22% of the excess over $41,775
24%	$89,076 to $170,050	$89,051 to $170,050	$178,151 to $340,100	$89,076 to $170,050
	Tax Owed $15,213.50 plus 24% of the excess over $89,075	**Tax Owed** $13,708 plus 24% of the excess over $89,050	**Tax Owed** $30,427 plus 24% of the excess over $178,150	**Tax Owed** $15,213.50 plus 24% of the excess over $89,075
32%	$170,051 to $215,950	$170,051 to $215,950	$340,101 to $431,900	$170,051 to $215,950
	Tax Owed $34,647.50 plus 32% of the excess over $170,050	**Tax Owed** $33,148 plus 32% of the excess over $170,050	**Tax Owed** $69,295 plus 32% of the excess over $340,100	**Tax Owed** $34,647.50 plus 32% of the excess over $170,050
35%	$215,951 to $539,900	$215,951 to $539,900	$431,901 to $647,850	$215,951 to $323,925
	Tax Owed $49,335.50 plus 35% of the excess over $215,950	**Tax Owed** $47,836 plus 35% of the excess over $215,950	**Tax Owed** $98,671 plus 35% of the excess over $431,900	**Tax Owed** $49,335.50 plus 35% of the excess over $215,950
37%	$539,901+	$539,901+	$647,851+	$323,926+
	Tax Owed $162,718 plus 37% of the excess over $539,900	**Tax Owed** $161,218.50 plus 37% of the excess over $539,900	**Tax Owed** $174,253.50 plus 37% of the excess over $647,850	**Tax Owed** $87,126.75 plus 37% of the excess over $323,925

Capital Gains

The same rules and rates still apply to capital gains:

- Capital gains on property held one year or less are taxed at an individual's ordinary income tax rate.
- Capital gains on property held for more than one year are taxed at more favorable capital gains tax rates depending on the taxpayer's regular income tax bracket.

2022 TAX RETURN THRESHOLDS FOR CAPITAL GAINS

Long-Term Capital Gains Tax Rate	Single	Married Filing Separately	Head of Household	Married Filing Jointly
0%	$0 - $41,675	$0 - $41,675	$0 - $55,800	$0 - $83,350
15%	$41,675 - $459,750	$41,675 - $258,600	$55,800 - $488,500	$83,350 - $517,200
20%	$459,750+	$258,600+	$488,500+	$517,200+

While there has been no legislative action to change the tax treatment on capital gains for 2022, it remains a topic of conversation and could change in the future.

KIDDIE TAX REMINDER ›

The unearned income of children and young adults is now taxed using the parent's marginal federal income tax rate (if higher than the child's). Unearned income comes from sources other than employment or business activity (i.e., interest, dividends, capital gains).

Items to Reconcile on 2022 Tax Return

TAX PAYMENTS FROM CORONAVIRUS IRA WITHDRAWAL

The CARES Act permitted individuals under the age of 59½ to withdraw up to $100,000 from retirement funds during 2020 for coronavirus costs without triggering the usual 10 percent early withdrawal penalty. There will be federal income tax on any coronavirus-related withdrawals, but taxpayers have the option of spreading the tax over three years or paying the entire tax in one year. If you repay the withdrawal to the account within three years, you can avoid the federal income tax. If the distribution is repaid, amended tax returns may be filed to claim a refund of federal income tax attributable to the amount repaid.

ELIGIBILITY FOR ACA PREMIUM TAX CREDIT

Each year, taxpayers who purchase health insurance through the Affordable Care Act exchange must reconcile their taxable income to the income used to determine the premiums paid in advance. This could result in either an additional tax credit or the repayment of any excess credit. The Inflation Reduction Act also extends Affordable Care Act premium tax credits, which were originally set to expire in 2022, for three more years. Now through 2025, taxpayers with household incomes exceeding 400 percent of federal poverty level may qualify for premium tax credits and a higher level of premium tax credit will be available.

PA TAX NOTE›

There's a new, permanent tax credit available to Pennsylvanians who care for a child or dependent. Passed as part of the 2022-23 state budget, the Child and Dependent Care Enhancement refundable credit can be claimed on state tax returns starting in 2023. Qualifying PA families will receive up to 30 percent of the child care expenses claimed on their federal tax returns. This could mean tax credits of $180 (one child) or $360 (two or more children) for households earning above $43,000, and $315 (one child) or $630 (two or more children) for households earning less than $43,000.

Provisions that Expired or Reset to Previous Levels

CHILD TAX CREDIT

The Child Tax Credit will still be available for taxpayers in 2022; however, the enhancements introduced in 2021 have now expired. The credit for 2022 is $2,000 per child under the age of 17.

DEPENDENT CARE CREDIT

Under COVID relief legislation, the maximum dependent care credit was $4,000 for one child and $8,000 for two or more children needing care. For 2022, the maximum credit is $1,050 and $2,100, respectively. Eligibility for this credit also reset to prior levels, with a 2021 phase out range of adjusted gross income between $125,000 and $438,000 (expected 2022 inflation adjustment forthcoming).

CHARITABLE CONTRIBUTIONS

The previous enhancements to deductible charitable contributions have now expired. This includes the additional $300/$600 charitable contribution deduction that was paired with the standard deduction in previous years.

Factors to Consider with Your Advisor

NET OPERATING LOSSES

Starting with losses arising after 2020, net operating losses may not be carried back but will be carried forward indefinitely until used up. Farming losses may be carried back two years and carried forward indefinitely.

INCREASED IRS ENFORCEMENT

The Inflation Reduction Act, signed into law on August 16, includes $80 billion of funding for the IRS, with $45.6 billion earmarked specifically for enforcement. The expanded enforcement is anticipated to generate around $200 billion of revenue over the next 10 years.

SALT CAP REMAINS ›

The Inflation Reduction Act does not address the $10,000 cap on the state and local income tax deduction, which primarily affects individuals living in high tax states such as New York and California.

SALE OF YOUR PERSONAL RESIDENCE

If you have a capital gain from the sale of your main home, you may qualify to exclude up to $250,000 ($500,000 for married filing jointly) of the gain from your taxable income. Certain requirements must be met to qualify for the exclusion, so consult your **RKL advisor** for details.

VIRTUAL CURRENCY AND YOUR TAXES

Virtual currency is a digital representation of value other than a government-issued currency. It can be purchased and sold through exchanges similar to stocks and bonds. Custody of virtual assets are stored in self-controlled wallets or custodial accounts through various institutions. Information used for tax reporting is typically provided through brokerage statements or data files similar to Excel.

For 2022, the IRS updated the virtual currency question on the first page of Form 1040. Taxpayers must answer yes or no to "At any time during 2022, did you: (a) receive (as a reward, award, or compensation); or (b) sell, exchange, gift, or otherwise dispose of a digital asset (or a financial interest in a digital asset)?"

Receiving, selling or exchanging virtual currency could trigger a reporting requirement. The selling or receipt of virtual currency is taxed at ordinary or capital gain tax rates depending on the nature of the transaction. Individuals who engage in virtual currency transactions should consult their **RKL advisors** to assess the tax requirements and impact.

INFLATION REDUCTION ACT EXTENDS BUSINESS LOAN LOSS LIMITATION RULES THROUGH 2028

The Inflation Reduction Act of 2022 contains provisions intended to fight climate change, reduce health care costs and lower the federal deficit, mostly paid for by two new corporate taxes.

By way of a last-minute amendment added on the Senate floor, however, the Inflation Reduction Act also includes a two-year extension of excess business loss limitation rules. This provision disallows excess business losses for non-corporate taxpayers for taxable years starting in 2021 through 2028 (it was previously set to expire on December 31, 2025, and was extended to December 31, 2026, by a 2021 law).

Education & Your Taxes

STUDENT LOANS

Debt Forgiveness

The Biden administration announced on August 24, 2022, that it will cancel up to $10,000 in student debt for borrowers earning $125,000 a year or less and up to $20,000 in student debt for Pell Grant recipients.

This follows the cancellation of nearly $32 billion in student loan debt primarily for victims of fraudulent for-profit schools and for permanently disabled borrowers.

Payback

In August, the Biden administration extended the payment pause on federal student loans for the final time through the end of 2022. On January 1, 2023, monthly payments and interest accrual on federal student loans will resume.

Interest Deduction

Borrowers can deduct education loan interest up to $2,500 per tax year, subject to income phase outs between $70,000 and $85,000 (single) and $145,000 and $175,000 (married filing jointly).

DID YOU KNOW? 529 ASSETS CAN BE USED TO PAY STUDENT LOANS

Distributions from a 529 plan can be used not only for college costs and K-12 education expenses, but also be used to reduce student loan debt. Under the SECURE Act of December 2019, account owners can use 529 funds to pay down student loans held by the beneficiary and each of the beneficiary's siblings with a lifetime limit of $10,000 per borrower. Pennsylvania conforms with this federal law, but not all states have followed suit, so watch for any state tax incurred by such a payout.

Education & Your Taxes (continued)

LIFETIME LEARNING CREDIT

This credit is capped at $2,000 per tax return and phases out for taxpayers with adjusted gross income above $69,000 (single) and $138,000 (married filing jointly). This credit is available to offset expenses related to tuition, fees and course-related books, supplies and equipment for all years of higher education, including additional courses to acquire or improve job skills.

AMERICAN OPPORTUNITY TAX CREDIT

Taxpayers with modified adjusted gross income of under $90,000 (single) or $180,000 (married filing jointly) may be eligible for a maximum credit of $2,500 for qualified tuition, fees and course material expenses paid during the tax year for themselves or their dependents who have not completed the first four years of post-secondary education. The credit is per eligible student.

Taxpayers who cannot benefit from their dependent's qualified education expenses for the American Opportunity Tax Credit because of the income limitations should consider this:

- The student can only claim this credit on their own tax return if they are not claimed as a dependent.
- The credit amount is limited to the tax due on the student's tax return.
- Taxpayers who are eligible to claim the American Opportunity Tax Credit should consider these factors if a dependent wishes to claim themselves in order to qualify for the economic stimulus payment:
- Taxpayer will lose the ability to claim education credits even if the taxpayer paid the qualifying expenses.
- The student may not be able to utilize the maximum credit.

EDUCATOR EXPENSE DEDUCTION

Eligible educators who buy supplies for their classrooms at their personal expense can deduct up to $300 of purchases, up $50 from the 2021 deduction amount.

State Tax Considerations for Remote Workers

Remote workers cause many tax considerations for their employers, but the issue of individual taxation for the remote workers themselves should not be overlooked. Even if your employer does not withhold income tax for every state (or locality) in which you work, you likely have filing obligations in those states where you were physically present. While some states provide a threshold of days in-state before you are subject to tax, about half of states consider you subject to tax based on one day of working in-state. Whether you travel regularly for work or have been able to take advantage of working remotely to periodically work somewhere other than your home state, it is important to understand where you may have individual tax filing obligations.

Foreign Individual and Expatriate Tax Considerations

U.S. TAXPAYERS WORKING ABROAD

U.S. citizens working abroad follow the same rules for filing income tax returns and paying estimated taxes as if they still resided in the United States. A U.S. citizen's worldwide income is subject to U.S. income tax (regardless of residence) and to annual filing requirements with the IRS. **There are a few tax considerations available for individuals working abroad:**

- **Foreign Tax Credit:** Generally speaking, a U.S. citizen who earns income while living abroad may claim a credit for taxes paid to a foreign government on this income. Credit limitations apply.
- **Foreign Earned Income Exclusion:** Qualified individuals may elect to exclude up to $112,000 (married filing separately) or $224,000 (married filing jointly) of foreign earned income for the 2022 tax year. Foreign earned income includes salaries/wages, allowances for housing and other expenses, business profits, royalties or rents tied to the performance of services, value of fringe benefits and certain other income provided by the employer.
- **Foreign Housing Exclusion/Deduction:** Qualified individuals can elect to claim an exclusion for housing costs considered paid with employer-provided amounts or deduct housing cost amounts paid with self-employment earnings.

FOREIGN INDIVIDUALS WORKING IN THE U.S. (U.S. NONRESIDENT)

A U.S. nonresident alien is any individual who is not a U.S. citizen and has not passed the green card test or substantial presence test. Nonresident aliens are subject to U.S. income tax only on their U.S.-sourced income. A foreign individual with either of the following U.S.-sourced income categories must file and pay any tax using Form 1040-NR, U.S. Nonresident Alien Income Tax Return.

- **Effectively connected income:** Income earned from the operation of a business in the U.S. or income from personal services earned in the U.S. is taxed at the same gradual rates as a U.S. person.
- **FDAP income:** Fixed, Determinable, Annual or Periodical (FDAP) income such as interest, dividends, pensions, annuities and any income that is not considered effectively connected income. FDAP income is taxed at 30 percent tax rate unless a lower tax treaty rate applies.

EXPATRIATION TAX

U.S. citizens who relinquish their citizenship or long-term residents who have ended their U.S. resident status for tax purposes could be subject to a mark-to-market/exit tax upon leaving the country. Expatriation tax provisions are complex and your **RKL advisor** can help plan and guide you through the process.

NEW FOR 2021 TAX YEAR AND BEYOND ›

The Schedule K-3 is a new extension of the Schedule K-1 to report items of international tax relevance from pass-through entities to partners and shareholders.

This schedule standardizes the reporting of international information from a pass-through entity, including the calculation of foreign tax credits and other items related to international tax reporting.

Foreign Financial Account & Asset Reporting Requirements

Two of the most common triggers for annual reporting of foreign financial accounts and assets are ownership of foreign bank accounts or assets and signature authority for a company's foreign bank account. Other reportable foreign financial accounts include investment or retirement assets held in foreign jurisdictions and foreign trusts. Your **RKL advisor** can assess and navigate the complex calculations and reporting requirements for these types of foreign asset holdings, which are reported to the U.S Department of Treasury on Form FinCen 114 and the IRS on Form 8938.

FORM 114, REPORTS OF FOREIGN BANK AND FINANCIAL ACCOUNTS (FBAR)

Taxpayers who own or have signature authority over foreign accounts with balances that total in excess of $10,000 must electronically file an FBAR. The $10,000 figure is the aggregate of all accounts, and each account is measured at its maximum balance during the year. The IRS defines authority as the ability to initiate account withdrawals and its definition of financial account includes, but is not limited to:

- Traditional bank accounts and other accounts held with a financial institution
- Brokerage or commodities accounts
- Insurance and annuity policies with a cash value
- Mutual funds

Filing deadline: FBARs are due April 15 following the calendar year reported and are filed with the U.S. Department of Treasury. Taxpayers are automatically granted a six-month extension until October 15 (no extension request needed).

Penalties: Non-willful failure to file an FBAR can trigger penalties of up to $13,481 per foreign account. Willful non-filers can be penalized up to $134,806 or 50 percent of the account value, and may also face criminal charges (depending on facts and circumstances).

FORM 8938, STATEMENT OF SPECIFIED FOREIGN FINANCIAL ASSETS

Under the Foreign Account Tax Compliance Act (FATCA), taxpayers who hold certain levels of foreign assets during or at the end of a tax year must report these holdings on Form 8938. Foreign financial accounts (reported via FBAR) and foreign non-account assets (i.e. foreign stock, securities or debt) are included in FATCA's definition of specified foreign financial assets. **Filing Form 8938 with the IRS does not relieve taxpayers of filing responsibility for FBAR (Form 114) with the U.S. Department of Treasury.**

Filing deadline: Form 8938 is attached to a taxpayer's annual return and must be filed by the due date, including extensions, for that return. For individuals and calendar-year C Corporations, this would be April 15 (April 18 for 2023) with a six-month extension available upon request.

Penalties: Failure to file Form 8938 can result in a $10,000 penalty. Continued failure after IRS notification can result in additional penalties of up to $50,000 and a 40 percent penalty on an understatement of tax attributable to non-disclosed assets.

Private Wealth

Quick Guide: Wealth Management Facts & Figures	
Traditional & Roth IRA Contribution Limits	$6,000 under age 50 (same as 2021 limit) $1,000 additional catchup contribution for ages 50+ (same as 2021 limit)
Roth IRA Contribution Income Limits	Based on Modified Adjusted Gross Income (MAGI) Single & HOH filers MAGI must be under $129,000 to contribute full amount • Phase out contribution from $129,000 - $144,000 Married Filing Joint filers MAGI must be under $204,000 to contribute full amount • Phase out contribution from $204,000 - $214,000
401(k), 403(b) and 457 Plan Elective Deferral Limits	$20,500 under age 50 $6,500 additional catchup contribution for ages 50+ (may not apply to all 457 plans)
SIMPLE IRA Elective Deferral Limits	$14,000 under age 50 $3,000 additional catchup contribution for ages 50+
Profit Sharing & SEP Plan Limits	Contribution limit is lesser of: • $61,000, or 25% of compensation (20% if self-employed) Maximum of $305,000 compensation limit
Health Savings Account (HSA) Contribution Limits	$3,650 for self-only coverage $7,300 for family coverage Additional $1,000 catchup contribution for ages 55+ for either plan
Federal Estate Tax Exemption Amount & Tax Rate	$12.06 million exemption amount 40% tax rate over exemption amount
Annual Gift Tax Exclusion	$16,000 per donor, per recipient, or $32,000 if gift-splitting with spouse (must be gifted by December 31 with no carry-over)
Required Minimum Distributions (RMDs) Resume	Individuals age 72 and older must continue taking RMDs during year 2022. RMDs resumed in year 2021 after the CARES Act of 2020, which allowed individuals to waive their 2020 RMD. 2022 RMDs are calculated based on December 31, 2021 account balances, using updated IRS Uniform Lifetime Table. The updated table results in lowered required payouts, due to longer assumed lifespans.
SECURE ACT Reminders	RMDs from retirement accounts begin at age 72 instead of 70½ (effective for individuals who reached age 70½ during year 2020 or later). Most non-spouse inherited IRAs must fully withdrawal the account by the end of the 10th year after the year of death (instead of over the beneficiary's lifetime). This essentially eliminates the stretch IRA for most beneficiaries. Review your beneficiaries and estate documents regularly.

LONG-TERM CAPITAL GAINS AND QUALIFIED DIVIDENDS TAX BRACKETS AND RATES

Filing Status	0% Rate	15% Rate	20% Rate
Single	$0 – $41,675	$41,676 – $459,750	$459,751+
Married Filing Jointly	$0 – $83,350	$83,351 – $517,200	$517,201+
Married Filing Separately	$0 – $41,675	$41,676 – $258,600	$258,601+
Head of Household	$0 – $55,800	$55,801 – $488,500	$488,501+
Estates & Non-Grantor Trusts	$0 – $2,800	$2,801 – $13,700	$13,701+

Financial & Estate Planning: Year-End Actions and Reminders

DEDUCTIBILITY REMINDER: EXCESS DEDUCTIONS ON TERMINATION OF ESTATE OR TRUST

The IRS in May 2020 confirmed the deductibility of excess deductions, which occur in the final year of an estate or non-grantor trust when expenses, such as attorney fees, accountant fees and administration fees exceed income (interest, dividends, etc.).

Trustees and executors should keep thorough records of all expenses. The excess deduction on termination may be comprised of several types of deductions, including:

- Those deductions allowable in arriving at adjusted gross income under Code Sec. 62 and Code Sec. 67(e)
- Itemized deductions under Code Sec. 63(d) allowable in computing taxable income
- Miscellaneous itemized deductions currently disallowed under Code Sec. 67(g)

LOCK IN FEDERAL ESTATE TAX PORTABILITY AT CURRENT HIGHER RATE

Electing portability allows a surviving spouse to use the deceased spouse's unused estate tax exemption. Based on the current uncertainty around the future of the federal exemption level, it is important to lock in portability now in case the current, historically high exemption drops down. In order to elect portability of the unused estate tax exemption, the surviving spouse must file a federal estate tax return and make this election.

Separate from federal portability, 12 states and the District of Columbia have their own estate tax and six states have an inheritance tax:

Estate Tax		Inheritance Tax
District of Columbia	Minnesota	Iowa
Connecticut	New York	Kentucky
Hawaii	Oregon	Maryland
Illinois	Rhode Island	Nebraska
Maine	Vermont	New Jersey
Maryland	Washington	Pennsylvania
Massachusetts		

Note: Hawaii and Maryland have portability for the state estate tax.

NEW IN 2022 ›

Decedent estates now have five years to request late portability election relief, up from the prior two year timeframe, per an IRS Revenue Procedure revised in July 2022.

Financial & Estate Planning (continued)

ONLY A FEW MORE YEARS TO USE OR LOSE CURRENT, ALL-TIME HIGH EXEMPTIONS

The estate tax exemption is one of several provisions of the Tax Cuts and Jobs Act that will revert to pre-2017 levels (from $12.06 million to $5 million, adjusted for inflation) at the end of 2025 if Congress does nothing.

Higher net worth individuals should consider making large gifts to family members or trusts as soon as possible to maximize the current exemption. If a $12.06 million gift does not make sense, a smaller gift between $5 million and $12.06 million can still work to effectively remove future growth from an estate and provide some benefit from the higher exemptions. A common strategy for married taxpayers is to make a gift to a spousal lifetime access trust (SLAT) where the non-donor spouse is a beneficiary of the trust. Your **RKL advisor** can help you design and implement a tax-advantaged gifting strategy.

Let's maximize the tax benefits of your legacy plans. Contact your **RKL advisor** or Amy Heim, Estates and Trust Tax Practice Leader, at **asheim@rklcpa.com**.

Financial & Estate Planning (continued)

INHERITED IRA CHANGES: NO MORE STRETCH TRANSFERS TO BENEFICIARIES

The SECURE Act included another major change: For 2020 and beyond, beneficiary recipients of IRAs may no longer use the stretch IRA strategy, which leveraged the IRA's tax deferral characteristics in taking only the RMD over a number of years. Instead of the stretch IRA strategy, the SECURE Act requires IRA beneficiaries (including those of Roth IRAs, unless you are the passing individual's spouse, as well as a few other exceptions) to distribute the entire IRA balance over 10 years after the original IRA owner passed away. Keep in mind, the beneficiary may elect to distribute as much or as little as they would like to over these 10 years, as long as the full balance is distributed to them by the end of year 10. It is also important to note that a failure to distribute the entire IRA balance on time to the beneficiary results in 50 percent penalty on the undistributed amount.

REVIEW DOCUMENTS REGULARLY AND CONSIDER BENEFICIARIES CAREFULLY

Best practice suggests an annual review of estate documents, including beneficiary designations. Assets with beneficiary designations such as retirement accounts, life insurance policies and transfer on death accounts are non-probate assets that follow the beneficiary designation, not governed by the will. In light of recent legislative changes and evolving personal circumstances, it is more important than ever to keep in touch with your RKL advisor to monitor and discuss the optimal IRA and RMD management strategies.

Another important estate planning consideration is the possible state income tax effect of naming beneficiaries for qualified retirement accounts. Various states have different tax rules and treatment for retirement accounts. As such, managing state income tax effects for account owners and beneficiaries may end up being more challenging than managing overall federal taxability.

For example, Pennsylvania offers a state tax exclusion for IRA distributions to PA residents aged 59½ or older. This exclusion also extends to distributions from the IRA to their estate, as well as to the designated beneficiary of the account owner after the owner's death. Not all states offer this tax exclusion, so it is important to consider the state tax effects of both the account owner and beneficiary's states of residency. Failure to correctly list beneficiaries as intended, or at all, could cause the recipient to miss important tax benefits and traits of the account that otherwise would be available to them.

Retiree Tax Information

2022 MEDICARE PER-PERSON PREMIUMS BASED ON 2020 INCOME

Single	Married Filing Jointly	Married Filing Separately	Part B Premium	Part D Premium
$0 - $91,000	$0 - 182,000	$0 - $91,000	$170.10	Your plan premium
$91,001 - 114,000	$182,001 - $228,000	N/A	$238.10	$12.40 + your plan premium
$114,001 - $142,000	$228,001 - $284,000	N/A	$340.20	$32.10 + your plan premium
$142,001 - $170,000	$284,001 - $340,000	N/A	$442.30	$51.70 + your plan premium
$170,001 - $500,000	$340,001 - $750,000	$91,001 - $409,000	$544.30	$71.30 + your plan premium
$500,001+	$750,001+	$409,001+	$578.30	$77.90 + your plan premium

Note: Modified adjusted gross income for Medicare premiums = adjusted gross income + tax-exempt income

SOCIAL SECURITY BENEFITS TAXABILITY

Single Filing Income*	Married Filing Jointly Income*	Percentage of Social Security Taxed
$0-$25,000	$0 - 32,000	0%
$25,001-$34,000	$32,001 - $44,000	Up to 50%
$34,001+	$44,001+	Up to 85%

*Adjusted gross income + nontaxable interest + ½ of Social Security benefits is the combined income used to determine taxable percent of Social Security

NOTE: Married filing separately income levels depend on living arrangements. If a taxpayer lived apart from their spouse for all of the tax year, follow the same taxability schedule as single filers. If the taxpayer and their spouse lived together at any time during the tax year, up to 85 percent of their benefits may be taxable.

Retiree Tax Information (continued)

QUALIFIED CHARITABLE DISTRIBUTIONS

Retirees age 70½ and older are eligible to take advantage of a common planning technique, while fulfilling their goals of donating directly to qualified charitable organizations from their IRA. These retirees are able to send a portion or all (up to $100,000 annually) directly to one or more charities of their choice that they donate to, all without needing to pay federal income tax on the donated distribution from their IRA. This is a tax-efficient planning technique that is helpful in situations where the retiree is charitably inclined, allowing them to lower their taxable income, while also working towards satisfying their annual required minimum distribution. Be sure to coordinate these qualified charitable distributions with your RKL advisor to ensure proper record keeping and tax reporting.

Qualified charitable distributions cannot be made to a donor advised fund, although it is worthwhile to speak with your RKL advisor on the key differences between QCDs and donor advised fund contributions to determine which strategy makes the most sense for you.

REMINDER, REQUIRED MINIMUM DISTRIBUTIONS START AT AGE 72

The SECURE Act of December 2019 changed the starting age for required minimum distributions (RMDs) from 70½ to 72, which provides more time for savings to grow tax-free. RMDs were entirely paused throughout the 2020 calendar year as part of the CARES Act pandemic relief provisions.

Starting in 2021, however, RMDs reverted to the SECURE Act approach and must be taken annually for individuals age 72 and older. RMDs should be calculated using the current Uniform Lifetime Table. The IRS introduced a new **Uniform Lifetime Table for RMDs in 2022** and beyond. Compared to the current table, which covers the remainder of 2021 RMDs, most individuals can expect to take a slightly smaller RMD amount under this new table.

ADDITIONAL STANDARD DEDUCTION AGE 65 AND UP

Many retirees take the standard deduction depending on their write-offs for charitable donations, mortgage interest, state and local taxes and more. Taxpayers age 65 and older are permitted to take an additional standard deduction.

Here are the limits for the 2022 tax year:

Filing Status	Additional Standard Deduction (Per Taxpayer)
Single or Head of Household	$1,750*
Married Filing Jointly or Separately	$1,400*

Note: The additional standard deduction also applies to blind taxpayers of any age. The amount doubles for taxpayers at least 65 years old AND blind.

Beware Wash Sale Rules

Selling an investment at a loss and replacing it with a substantially identical or the same investment within 30 days before or after the sale (61-day window in total) creates a wash sale. In these cases, the IRS will not allow a tax loss to be harvested. The wash sale rule is in effect across all types of accounts, which excludes the possibility of evading the rule by selling a holding at a loss within an after-tax account and purchasing a similar holding within the wash sale period within a qualified account. The wash sale rules are in effect for both spouses married filing jointly.

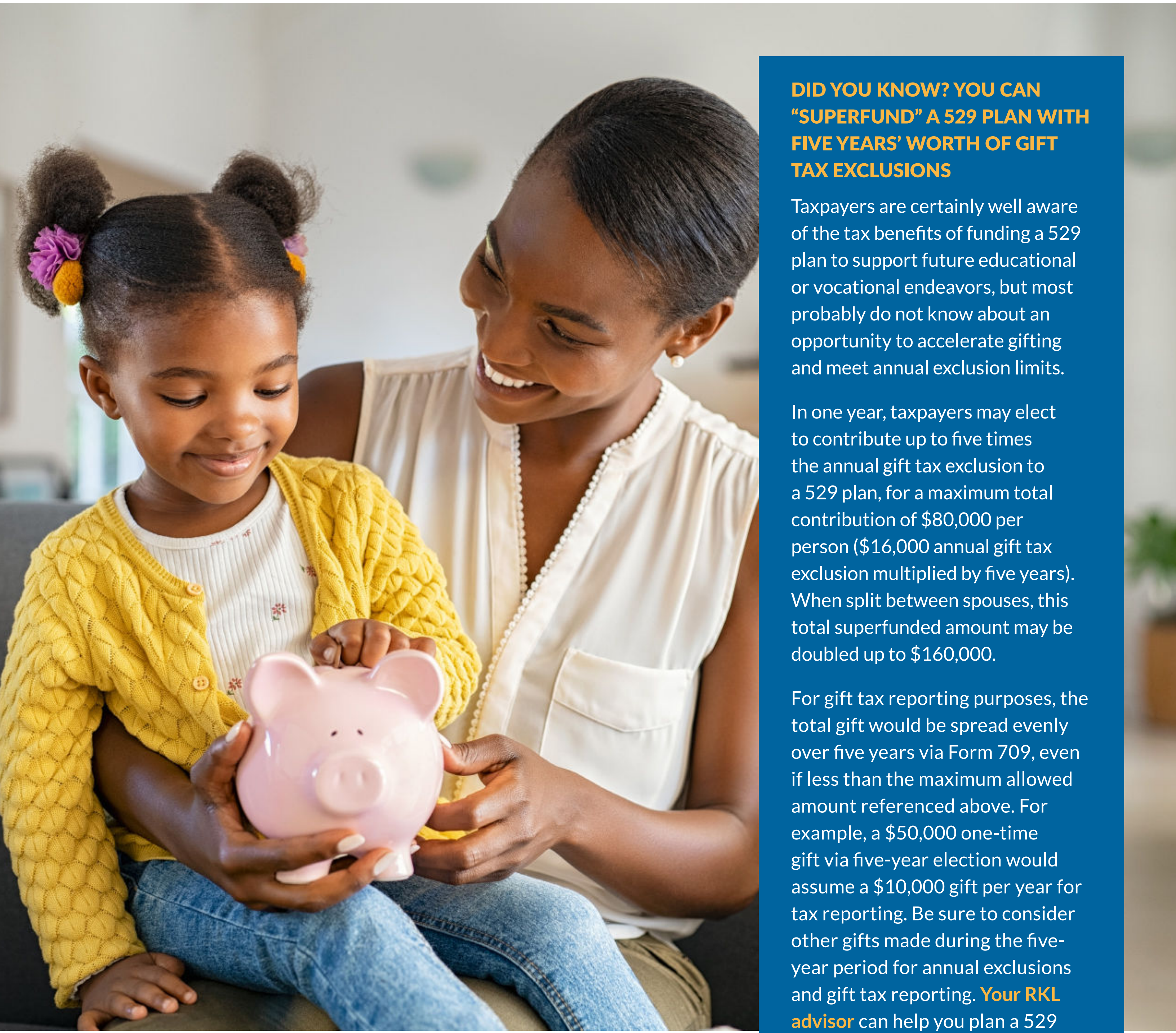
Keep in mind that federal wash sale provisions do not apply for Pennsylvania personal income tax purposes. In Pennsylvania, every transaction is considered separate and independent of any subsequent transaction. Also remember that one spouse's loss does not offset another spouse's gain for Pennsylvania tax purposes.

Virtual Currency and Your Taxes

The IRS considers to be property any virtual currency that uses cryptography to secure transactions that are digitally recorded on a distributed ledger. As such, a taxable event is triggered when virtual currency holdings are sold for cash, exchanged for another type of virtual currency or used to purchase services or goods. Simply purchasing holdings of cryptocurrency and holding them, no matter for how long, does not create a taxable event.

HERE'S AN EXAMPLE:

If you use your digital wallet holding Bitcoin to purchase goods, you would have to report and pay capital gains tax on any gain on the holding used to purchase those goods. If you held the crypto holding for less than a year, the gain on the sale would be treated as a short-term gain, and treated as a long-term gain if held for over a year. Learn more on **page 7** or discuss with your **RKL advisor**.



DID YOU KNOW? YOU CAN "SUPERFUND" A 529 PLAN WITH FIVE YEARS' WORTH OF GIFT TAX EXCLUSIONS

Taxpayers are certainly well aware of the tax benefits of funding a 529 plan to support future educational or vocational endeavors, but most probably do not know about an opportunity to accelerate gifting and meet annual exclusion limits.

In one year, taxpayers may elect to contribute up to five times the annual gift tax exclusion to a 529 plan, for a maximum total contribution of $80,000 per person ($16,000 annual gift tax exclusion multiplied by five years). When split between spouses, this total superfunded amount may be doubled up to $160,000.

For gift tax reporting purposes, the total gift would be spread evenly over five years via Form 709, even if less than the maximum allowed amount referenced above. For example, a $50,000 one-time gift via five-year election would assume a $10,000 gift per year for tax reporting. Be sure to consider other gifts made during the five-year period for annual exclusions and gift tax reporting. **Your RKL advisor** can help you plan a 529 superfunding approach that supports your gifting strategy and lifetime estate exemption.

Federal Actions We're Tracking

BUILD BACK BETTER OUT, INFLATION REDUCTION ACT IN

The Build Back Better Act that generated so much noise in 2021 and early 2022 was unable to gain support from key senators to secure its passage. In August 2022, a greatly scaled back version containing some key elements of the Build Back Better Act was branded as the Inflation Reduction Act of 2022 and signed into law. **The Inflation Reduction Act includes the following changes:**

A corporate minimum tax of 15 percent for corporations with income greater than $1 billion with some exceptions for private equity funds and certain manufacturers

$80 billion of funding for the IRS, with $45.6 billion earmarked specifically for enforcement. The expanded enforcement is anticipated to generate around $200 billion of revenue over the next 10 years.

A 1 percent excise tax on the value of corporate stock buybacks of publicly traded companies set to go into effect January 1, 2023.

A two-year extension of excess business loss limitation rules. This provision disallows excess business losses for non-corporate taxpayers for taxable years starting in 2021 through 2028 (it was previously set to expire on December 31, 2025, and later extended in 2021 to December 31, 2026).

It is worth noting that the Inflation Reduction Act does not address the $10,000 cap on the state and local tax deduction, which would primarily affect high-tax states such as New York and California. The RKL team will continue to monitor the impact of the Inflation Reduction Act and any other legislation that may affect individual taxpayers – follow us on **LinkedIn** and **subscribe to our e-news** for the latest.

FY 2023 BUDGET AND GREEN BOOK

On March 28, 2022, the Biden administration released the FY 2023 budget proposal along with the U.S. Department of the Treasury's Green Book, which outline the administration's proposals for legislative change. While the proposals are unlikely to become law at this point, it is possible that pieces of them could slip into a bill, particularly the Inflation Reduction Act discussed above. For more details on the FY 2023 and Green Book proposals, visit the **RKL Insights blog**.

PLANNING TIP ›

Even though estate tax law changes appear to be off the table for now, significant changes are on the horizon in 2026 with estate tax exemptions set to be cut in half. Taxpayers should continue to talk with their advisors about planning while favorable conditions still exist.

Federal Actions We're Tracking (continued)

PROPOSED REGULATIONS UNDER SECURE ACT OF 2019

The SECURE Act made significant changes to the required minimum distribution rules related to retirement plan accounts after a participant's death. The main change was that a retirement account must generally be distributed within 10 years of the participant's death. Most advisors interpreted that to mean distributions could be taken any time within the 10-year period.

On February 22, 2022, the IRS issued ***proposed*** regulations that indicate otherwise, if a participant dies on or after his or her required beginning date. In that case, the beneficiary must make withdraws under the life expectancy rules during the 10-year period until the account is fully withdrawn. It is important to note that proposed regulations do not become law and are still subject to change until finalized, so we will continue to watch.

SECURE ACT 2.0

The Securing a Strong Retirement Act of 2021 (aka Secure Act 2.0) passed the House on March 29, 2022 and versions of similar bills won approval from Senate committees in June 2022. While many of the common provisions are more technical in nature and aimed at retirement plan design, there are provisions that alter the rules around required minimum distributions (RMDs). Most notably, the required beginning date for taking RMDs would be increased from age 72 to age 75 by 2031. The Secure Act 2.0 has large bipartisan support (having passed the House by a vote of 414-5) and is likely to become law at some point in 2022.

PLANNING TIP›

Interest rates also play a role in the effectiveness of certain strategies. While interest rates have increased in the first half of 2022, rates are still relatively low and conducive to many planning strategies. Current high estate tax exemptions will remain in place through the end of 2025 and will likely see some more significant inflation adjustments between now and then. Clients should plan now and not wait until changes are imminent.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Business **Tax**

Tax planning isn't a once-and-done effort reserved solely for year end. Business decisions and plans made throughout the year can have significant implications for your tax position. Your RKL advisor can ensure you are making the most advantageous decisions and considering all possible tax impacts. **Reach out to them** to discuss if any of these apply to your organization or you are considering:

- Real estate transactions
- Mergers and acquisitions
- Opening a new location
- Ownership changes

Key Business Tax Filing Deadlines

Tax Form	Due Date(s) (for calendar year entities)
Partnerships (Form 1065) & S Corporations (Form 1120S)	March 15, 2023
C Corporations (Form 1120)	April 18, 2023
Employee Benefit Plans (Form 5500)	July 31, 2023
Extended return filings for partnerships & S Corporations	September 15, 2023
Extended return filing for C Corporations & Employee Benefit Plans	October 16, 2023

Payroll Return Filing Deadlines	
Tax Form	**Due Date(s)** **(for calendar year entities)**
Forms 1094-C and 1095-C *(health insurance offer and coverage info)*	March 2, 2023 to employees February 28, 2023 to IRS if filing hard copy March 31, 2023 to IRS if e-filing
Form 1099 *(see below for 1099-NEC – nonemployee compensation)*	February 15, 2023 to recipients February 28, 2023 to IRS if filing hard copy March 31, 2023 to IRS if e-filing
Forms W-2, W-3 and 1099-NEC	January 31, 2023 to employees/recipients, Social Security Administration and IRS if filing hard copy or e-filing
Form W-4: Employees who claimed exempt must submit a new form *(new for 2022)*	February 15, 2023

Nonprofit Form 990 Series Filing Deadlines	
Filing for December 31 year-ends	May 15, 2023
Extensions for December 31 year-ends	November 15, 2023
Filing for June 30 year-ends	November 15, 2023
Extensions for June 30 year-ends	May 15, 2024
All other year-ends	15th day of the fifth month following the end of the organization's taxable year (extensions due six months after that date)

Note: The Taxpayer First Act of 2019 requires tax-exempt organizations to file information returns and related forms electronically.

New Provisions and Changes for 2022

DIGITAL PAYMENT REPORTING

Does your business or organization accept payments via online systems such as PayPal, Venmo or Square? Do you use online retail platforms such as Etsy or eBay? Starting this year, these types of services were required to lower the threshold for IRS reporting from $20,000 in transaction per year to $600 per year. This change, which was enacted by Congress in 2021, does not explicitly address whether these transactions amount to income, but it will provide the IRS with more information for compliance and enforcement purposes.

INCREASE TO STANDARD MILEAGE RATE FOR BUSINESS TRAVEL

As a result of rising gas prices, the IRS instituted a mid-year increase in the standard mileage rate for business travel. Effective July 1, 2022, the rate is 62.5 cents per mile, up four cents from the start of 2022. The charitable organizations mileage remains unchanged at 14 cents per mile. This is the first mid-year increase since 2011.

The optional business standard mileage can be used to calculate the deductible costs of operating a vehicle for business use instead of tracking actual costs. The rate is also a benchmark used by the government and businesses to reimburse employees for mileage.

REQUIRED CAPITALIZATION OF R&D EXPENDITURES

Starting on January 1, 2022, businesses must capitalize and amortize all research and development (R&D) expenses from the current tax year. This new requirement stems from 2017's Tax Cuts and Jobs Act changes to Section 174 of the Internal Revenue Code. Keep in mind, the R&D costs mentioned here are much broader than those that qualify for the R&D tax credit **(read more about the R&D credit on page 42)**.

Instead of deducting R&D expenses in the year incurred, businesses are now required to capitalize and amortize such expenses over a five-year period for U.S.-based research and a 15-year period for offshore research. This requirement also applies to software development expenses, which were previously handled under a different timeline. Two notable exceptions to this rule are expenditures for land or property improvement and exploration expenditures related to mining or drilling.

If a capitalized R&D cost is disposed, retired or abandoned, no deduction is allowed for that expenditure.

5 & 15 Years

The new capitalization and amortization requirement for U.S. and offshore R&D expenditures, respectively.

ACTION ITEM: Develop a system to track R&D costs incurred in 2022.

GROSS RECEIPTS THRESHOLD RAISED FOR SMALL BUSINESS CATEGORIZATION

More corporations and partnerships may be considered small business taxpayers, thanks to a million dollar increase in the gross receipts threshold. Small business classification allows corporation or partnership taxpayers to avoid certain limitations or adjustments, such as eligibility for cash basis accounting, exemption from Section 263a Uniform Capitalization rules and exclusion from Section 163(j) business interest limitation.

A corporation or partnership qualifies as a small business taxpayer for any taxable year if it meets the gross receipts test under Section 448(c), which is calculated by taking the average annual gross receipts for the three-year period ending with the preceding taxable year. For 2022, the small business gross receipts cutoff amount has been adjusted to $27 million, up from $26 million in 2021. Your **RKL advisor** can help you determine classification based on gross receipts.

CHANGE IN CALCULATION FOR DEDUCTIBLE BUSINESS INTEREST EXPENSES

Does your business have average gross receipts greater than $27 million for the past three tax years? If so, you are subject to a limitation on deductible business interest expense under Section 163(j). For tax year 2022, the calculation for deductible business expenses has changed once again.

From 2017 through 2021 (under the Tax Cuts and Jobs Act), taxpayers calculated the basis for the business interest expense deduction, referred to as adjusted taxable income (ATI), in a manner similar to EBITDA (earnings before interest, taxes, depreciation and amortization). Now, the basis for this calculation no longer includes an add-back for depreciation and amortization, effectively making the ATI calculation similar to that of EBIT (earnings before interest and taxes).

Starting in 2022, the basis for the business interest expense deduction calculation no longer includes an add-back for depreciation and amortization.

Section 163(j) reminders:

- Any disallowed deduction for business interest is carried forward to future years in which a business generates excess taxable income.
- The new Section 163(j) provisions taking effect in 2022 increase the likelihood that some or all of the deduction for business interest will be disallowed for businesses that tend to generate large amounts of interest, depreciation and amortization expenses (such as real estate entities).
- Real estate entities and farming businesses may choose to make an irrevocable election out of Section 163(j) provided that they use the Alternative Depreciation System (ADS) for depreciation, as opposed to the traditional Modified Accelerated Cost Recovery System (MACRS). ADS results in longer cost recovery periods and does not allow bonus depreciation.
- Entities (other than tax shelters) with average annual gross receipts of less than $27 million for the past three tax years, including aggregation of entities with common ownership, are exempt from Section 163(j) and the business expense limitation does not apply.
- Based on the bonus deprecation tax break for qualified improvement property afforded by the CARES Act of 2020, real estate businesses should consider whether an election out of Section 163(j) provides more benefit than cost. **Your RKL advisor** can help you devise a tax strategy that results in the most optimal benefit for your business.

Provisions Ending or Changing for 2023

BUSINESS MEALS & ENTERTAINMENT DEDUCTION

2022 could be the last year for businesses to deduct 100 percent of meals purchased at restaurants. The 100 percent deduction was part of the Consolidated Appropriations Act of 2021 and was intended to help support the restaurant industry during the pandemic. Unless Congress votes to extend the temporary 100 percent deduction, it would revert back to the previous 50 percent deduction in 2023.

In order to be 100 percent deductible in 2022, a business meal must be made for immediate consumption and cannot be lavish or extravagant. Meals from grocery stores, liquor stores, convenience stores, vending machines and other non-restaurant businesses that sell primarily pre-packaged foods remain at the 50 percent deduction.

On the other hand, business entertainment, amusement and recreation expenses have been entirely nondeductible since 2018, according to the Tax Cuts and Jobs Act (TCJA). The cost of facilities used in connection with such activities and travel expenses to and from these events are also nondeductible. This treatment will likely continue until at least 2025, when the TCJA is set to expire.

Keep in mind, however, that the cost of meals associated with entertainment expenses can be deductible if they are purchased separately, or if they are split out from the cost of the entertainment on the invoice. Otherwise, the cost of these meals are nondeductible.

The cost of meals associated with entertainment expenses can be deductible if they are purchased separately, or if they are split out from the cost of the entertainment on the invoice. Otherwise, these costs are nondeductible.

BONUS DEPRECIATION RATE TO DROP 20 PERCENT

The Tax Cuts and Jobs Act (TCJA) doubled the bonus depreciation rate to 100 percent for qualifying new and used property placed in service after September 27, 2017, through 2022. Starting January 1, 2023, bonus depreciation begins to phase out by 20 percent each year until it reaches zero for property placed in service after 2026. There is still time to take advantage of the 100 percent rate before the end of calendar year 2022. Read more about bonus depreciation and other fixed asset planning strategies **on page 37**.

CORPORATE TAX CHANGES ON THE WAY IN 2023 VIA INFLATION REDUCTION ACT

The Inflation Reduction Act of 2022 contains provisions intended to fight climate change, reduce health care costs and lower the federal deficit, mostly paid for by two new corporate taxes:

- A new 15 percent minimum tax on corporations with income greater than $1 billion effective for tax years starting after December 31, 2022, with some exceptions for private equity funds (and their smaller subsidiaries) as well as certain manufacturers taking advantage of accelerated depreciation
- A 1 percent excise tax on the value of corporate stock buybacks of publicly traded companies, also set to go into effect January 1, 2023

Business Owners: Don't Overlook These Strategies

LAST IN, FIRST OUT (LIFO) INVENTORY METHODOLOGY

LIFO has always been an attractive option for many businesses with $1 million or more of inventory, but current historically high inflation makes now an even more valuable time to capitalize on external market conditions and consider a conversion to this methodology. LIFO produces savings by moving inflationary costs from the balance sheet where inventory is listed to the income statement. For companies with inventory inflation costs, LIFO acts like an annuity that provides annual returns and long-term benefits, such as reduced net income, improved cash flow and significant tax deferral.

RKL has helped clients defer more than $71 million of income using LIFO and over $45 million of income for 2021 alone, generating tens of millions of dollars of tax savings for owner returns or business reinvestment. **Let's find out if your business is a good candidate for LIFO.** **Contact your RKL advisor** before the end of the year.

EMPLOYEE RETENTION TAX CREDIT (ERTC) STILL AVAILABLE

Although the ERTC program ended on September 30, 2021, eligible employers still have a three-year statute of limitation to amend payroll tax returns and claim their credits on wages paid from March 12, 2020, through September 30, 2021. The credit amount is 70 percent of qualified wages up to a $10,000 limit per quarter (in other words, a maximum of $7,000 per employee per quarter). Introduced via the CARES Act, the ERTC is a refundable payroll tax credit for organizations that either had a full or partial suspension of operations OR experienced at least a 50 percent (for 2021, 20 percent) reduction in gross receipts as compared with the corresponding quarter in 2019. Organizations who received PPP loans are eligible to also claim this credit.

SECTION 1202 QUALIFIED SMALL BUSINESS STOCK GAIN EXCLUSION

Since 1993, stockholders have been able to avoid paying taxes on gains from the sale of qualified small business corporation stock. This strategy has largely flown under the radar, but it is something to consider for investors in smaller enterprises or start-up companies. There are a number of caveats and conditions, which your RKL advisor can apply to the specifics of your stock sale. If you hold C corporation stock issued since 1993, be sure to raise this opportunity with **your RKL advisor** during year-end planning meetings. You may be eligible to exclude gains up to $10 million (single and married filing jointly) or $5 million (married filing separately).

Other Business Tax Planning Considerations

NET OPERATING LOSS RULE AND LIMITATION CHANGES

Since January 1, 2021, most taxpayers can no longer carryback net operating losses (NOLs). On that date, NOL treatment reverted back to the limitations put into place under the Tax Cuts and Jobs Act of December 2017 after a temporary reprieve during the pandemic via the CARES Act.

Currently, NOLs may not be carried back and may be carried forward indefinitely until fully utilized (with the exception of certain farming losses). Deduction of any losses incurred in tax years beginning after December 31, 2020, is capped at 80 percent of excess taxable income.

For non-corporate taxpayers, business losses that exceed the loss limitation threshold and thus are disallowed in the current tax year will be treated as an NOL carryover to the following year. These excess business losses take effect when business loss exceeds trade or business income by more than $500,000 for married filing joint individuals and by $250,000 or more for other non-corporate taxpayers. Pass-through business owners who struggled during 2022 can calculate their excess business loss limitation on Form 461.

Watch state NOL limits: When planning for state taxes due with fourth quarter estimates, extensions or returns, be aware that some states are limiting the usage of NOL carryforwards. For example, Pennsylvania's NOL deduction is capped at 40 percent of income and California is not allowing NOLs from 2020 through 2021 for corporations with current year income of $1 million or more.

NOL LIMITATION CAPPED AT

80%

OF TAXABLE INCOME

(from 2021 tax year on).

S CORPORATION BASIS CALCULATION

In 2021, the IRS created Form 7203, S Corporation Shareholder Stock and Debt Basis Limitations, to report potential limitations of a shareholder's share of an S Corporation's deductions, credits and other items that can be deducted on the shareholder's tax return.

Shareholders must file Form 7203 if they:

- Are claiming a deduction for a loss
- Received a distribution from an S Corporation
- Disposed of stock during the year
- Received a loan repayment from an S Corporation

NEW SINCE 2021

Form 7203 is used to report potential limitations of a shareholder's share of S Corporation deductions, credits and other items that can be deducted on a shareholder's tax return.

Contact **your RKL advisor** to discuss the impact of this new basis reporting requirement on your tax situation.

S Corporation basis refresher: On the surface, S Corporation basis seems like a simple concept; however, there are several complexities related to calculating basis that can trigger tax consequences for shareholders, such as:

- Non-dividend distributions are tax-free to the extent they do not exceed the shareholder's stock basis.
- A shareholder must have adequate, above zero stock or debt basis to claim a loss or deduction allocated from an S Corporation.
- If losses exceed stock basis, excess losses can be applied to reduce debt basis.
- If losses exceed shareholder basis in stock and debt, the losses are suspended and carried forward to future years.
- If a shareholder uses losses to reduce debt basis and the debt is repaid prior to the basis being fully restored, the shareholder will recognize gain for the excess.
- When stock is sold or disposed of, basis needs to be established to determine the correct gain or loss on the disposal.

There are two types of basis for S Corporation — stock and debt — each with its own unique calculation method:

Stock basis starts with the original shareholder capital contribution. Each year, that amount is increased by income items and capital contributions, decreased for distributions, decreased for non-deductible non-capital expenses and depletion and decreased for items of loss and deduction.

Debt basis starts with the amount the corporation owes the shareholder. It is then increased by other loans made to the corporation, decreased by loan payments from the corporation and adjusted for losses or deductions in excess of stock basis. Debt must run directly from shareholder to S Corporation.

BEST PRACTICE

Keep good records of basis calculations, track them year over year by preparing Form 7203 annually and consider the shareholder tax implications before making decisions.

State and Local Tax Hot Topics

State and local taxes (SALT) are a dynamic and nuanced realm. While much of what you read elsewhere in this guide regarding federal income tax planning impacts state income tax as well, there are a whole host of additional considerations for state income taxes, plus sales and use taxes aren't even contemplated at all at the federal level.

While sales tax has been the hottest topic in SALT since 2018 because of the U.S. Supreme Court's Wayfair decision that ruled economic nexus to be valid, the landscape is shifting. As of January 1, 2023, every state with a sales tax is imposing economic nexus, and most businesses are aware of economic nexus, if not fully compliant. Over the past 12 to 18 months, the focus of the SALT world has moved substantially back to income tax, both in the context of what is currently happening and what we see on the horizon.

Need to sort through the state tax implications of business decisions? Contact your **RKL advisor** or Michael Bannasch, State and Local Tax Practice Leader, at **mrbannasch@rklcpa.com**.

INCOME TAX PLANNING

As mentioned, federal income tax planning impacts state income taxes, but it doesn't cover everything that should be considered for state income taxes. The primary additional considerations are nexus (whether you are taxable in a state) and apportionment (how much of your income the state will get to tax).

- **Nexus:** Between changing laws and changing business operations, the question of where you have nexus is an important issue to revisit periodically. Did you hire a remote worker in a new state or have an existing employee move there? Do you provide services to any customers in a new state? Although COVID is still around, states are no longer providing the relief from nexus that they did early in the pandemic, so these types of presence in a state will likely make you subject to income tax in that state. The days of being able to do a one-time nexus study are gone, and businesses should be prepared to revisit this issue each year end, if not more frequently.
- **Apportionment:** At least two more states shifted to single sales-factor apportionment and market-based sourcing of service revenue in 2022, continuing a trend that has states focusing on taxing businesses that sell into their state instead of the traditional apportionment rules that resulted in in-state businesses bearing heavier tax burdens. Like nexus, periodically revisiting this issue, especially market-based sourcing of services, is advised, as the service sourcing rules can yield some improper results if a business just reports their sales by state based on billing address of their clients.

PASS-THROUGH ENTITY TAX ELECTIONS

The Tax Cuts and Jobs Act of 2017 imposed a $10,000 cap on federal itemized deductions for state and local taxes for individuals. In an effort by states to help their residents avoid the federal SALT deduction cap, about 30 states have developed a work-around that lets pass-through entities elect to pay income taxes at the entity level instead of having the individual owners pay the tax. This moves the deduction for the state income taxes from an individual itemized deduction subject to the $10,000 cap to a non-itemized business deduction with no limitation, and the IRS has blessed this strategy.

Although there are definite federal tax advantages for pass-through entities and their owners to make these state elections, this strategy may cause state-level tax increases that cancel out the federal benefit. In particular, owners that reside in a state other than the one for which an election is being made can lose their resident-state credit for tax paid to other states. Thus, proper analysis of these elections on a state-by-state basis is necessary to ensure that overall tax savings is maximized, and elections aren't made that will harm the owner group. With many states requiring elections annually and election due dates sometimes ahead of tax return filing deadlines, year-end is a perfect time to consider which, if any, state elections are beneficial for your business.

BUSINESS WEBSITE ACTIVITY AND STATE INCOME TAX IMPACT FOR MULTISTATE BUSINESSES

Businesses that only sell tangible personal property have long been protected from state income taxes in states where they have no physical presence or their in-state presence only consists of employees or independent contractors merely soliciting sales. This protection stems from a 1959 federal law referred to as Public Law 86-272. Unfortunately, states are banding together to attack this protective federal law, and many previously protected businesses should expect states to pursue them for income tax beginning in 2022.

This attack was spearheaded by the Multistate Tax Commission (MTC), an intergovernmental state tax agency that brings states together to work toward uniformity in tax laws. The MTC has long provided an interpretation of P.L. 86-272 with suggestion to the states that they adopt that interpretation as their official stance on the issue of which in-state activities are protected and which are not. While not everyone has agreed with the interpretation over the years, it was still appreciated by the business community, as it put some meat on the bones of what is, admittedly, a very sparsely worded federal law.

However, many outside of the MTC and state taxing authorities feel the MTC's new revision to this interpretation goes too far and effectively guts the protections provided by Congress. The new interpretation says that any interactivity beyond sales solicitation on a business's website will violate P.L. 86-272 protection.

If you answer yes to any of the below questions, website activity by out-of-state individuals could cause your business to lose its P.L. 86-272 protection:

- Does your website provide post-sale customer support via chat or an email link?
- Do you accept job applications for non-sales positions on your website?
- Do you put cookies on the computers of people who browse your website for the purpose of adjusting production or identifying/developing new products to sell?

While the MTC provides an interpretation that it suggests states adopt, it is up to the states to actually impose this new interpretation on businesses. So far, California and New York have officially announced that it is their new position that an interactive website can cause the loss of P.L. 86-272 protection in their states simply by having people in those states use the website. Many more states will jump on this bandwagon, and businesses need to be prepared to understand their new exposure to income tax and react accordingly.

HERE'S AN EXAMPLE:

A Pennsylvania business has been very careful to avoid activities in California that would subject it to income tax beyond the state's $800 minimum tax. Now, if that business website has a chat function and a California customer asks for assistance with the product they purchased, this would cause the business to violate P.L. 86-272 protection and subject it to income tax in California.

STATE INCOME TAX CONSEQUENCES OF REMOTE WORKERS

If your business has employees working remotely, you will generally be subject to tax compliance obligations in the states and localities in which they work. This can include everything from having to withhold income tax from that employee in a new jurisdiction to subjecting the company (or its owners) to income tax. For instance, if you let a valued back-office employee keep working for you after they moved to a new state, your company (or owners, if you are a pass-through entity) is now subject to income tax in that state. These new tax obligations should not be overlooked as you consider where to hire new employees or let existing employees relocate. RKL's **SALT team** can analyze these obligations for you to help you make well-informed hiring/relocation decisions taking all matters into account.

Fixed Asset Planning

Purchased new equipment? Placed new or used assets into service? Constructed, renovated or purchased real property? Expanded your company's vehicle fleet? If you encountered these scenarios during 2022, your business may be eligible for tax benefits. Below are some fixed asset planning strategies and factors to consider. Contact your **RKL advisor** to find out which tax strategy is best for you.

ACT NOW: 100% BONUS DEPRECIATION ENDS THIS YEAR

The Tax Cuts and Jobs Act (TCJA) made significant changes to bonus depreciation, most notably doubling the bonus rate to 100 percent for qualifying property through 2022, and expanding it to include used property. Bonus depreciation is mandatory unless a taxpayer makes an election out for any class of property during the taxable year. The bonus depreciation rate is dependent upon the acquisition and in-service date. **The bonus rates follow by year:**

Placed in Service Year	Bonus Rate	LPPP & Certain Aircraft
9/28/2018 – 12/31/2022	100%	100%
2023	80%	100%
2024	60%	80%
2025	40%	60%
2026	20%	40%
2027	None	20%

*LPPP = Longer Production Period Property

USED PROPERTY BONUS DEPRECIATION REQUIREMENTS

For used property, there are certain acquisition requirements to be eligible for bonus depreciation. Three of the most significant are:

1. Written binding purchase contract must be dated after September 27, 2017;
2. Taxpayer or a predecessor may not use the property prior to the acquisition if holding a depreciable interest; and
3. Acquisition must occur by purchase (related party considerations).

BONUS DEPRECIATION AND NEW PROPERTY

For new construction (or self-constructed property), bonus depreciation is applicable if "physical work of a significant nature" and the in-service dates occur after September 27, 2017. "Physical work of a significant nature" begins at the time the taxpayer incurs more than 10 percent of the total cost of the project.

DID YOU KNOW? BONUS DEPRECIATION AT THE STATE LEVEL

Only about 15 states conform to federal 100 percent bonus depreciation, and some have placed restrictions on the ability to change depreciation of Qualified Improvement Property (QIP).

DO YOU HAVE QUALIFIED IMPROVEMENT PROPERTY?

Qualified Improvement Property (QIP) is a tax strategy with a 15-year depreciable life over the straight-line method and is eligible for bonus depreciation after December 31, 2017.

QIP includes certain interior renovations to a commercial building already in service by any taxpayer.

QIP excludes elevators, escalators, building footprint enlargement and internal structural framework (load-bearing internal walls and other supports essential to building stability or shell).

IMMEDIATELY EXPENSE ASSETS UNDER SECTION 179

Owners can garner more immediate savings from business expenditures through Section 179 expensing. Section 179, also known as the Small Business Asset Expensing Election, lets owners immediately expense the cost of eligible new property rather than capitalizing them and waiting for depreciation.

Eligible Property Examples	2022 Limits	Keep in Mind
Tangible personal property, software, equipment, qualified improvement property, certain commercial building subsystems including roofs, HVAC, alarm systems	Section 179 expenses are only deductible up to taxpayer income in a given year (cannot take into a loss). For 2022, allowable expense limit is $1.08 million and spending cap phase out starts at $2.7 million.	Use of Section 179 expensing for certain improvement property could negatively impact the Qualified Business Income deduction for certain entities

PA TAX NOTE ›

As part of the 2022-23 state budget, Pennsylvania personal income taxpayers can now take the same amount of Section 179 deduction as federal (previously limited to $25,000 per year) starting in 2023.

CHECK FOR EXPENSE OPPORTUNITIES UNDER TANGIBLE ASSET REGULATIONS

It has been more than five years since Tangible Asset Regulations (TARS) came into existence and organizations filed initial Forms 3115, Change of Accounting Method, to adopt them. One aspect of TARS dictates how and if replacement assets are capitalized or can be recognized as repair and maintenance expenses. Now that the five-year period has passed, organizations can once again review fixed assets to see if anything can be expensed instead of capitalized and reevaluate asset lives to determine if a change is warranted.

Fixed Asset Planning (continued)

CONSIDER ALTERNATIVE DEPRECIATION LIFE FOR OLDER AND NEWER RENTAL PROPERTIES

Under the TCJA, residential rental property held by an electing real property trade or business now has a 30-year recovery period under alternative depreciation system (ADS) instead of 40 years. This is especially important for those entities who adopted ADS in order to avoid the Section 163(j) interest limitation. The Taxpayer Certainty Act of December 2020 expanded eligibility to include property in service before January 1, 2018. As a result, this now applies to both older and newer properties. Under Revenue Procedure 2021-28, taxpayers can change an ADS life from 40 to 30 years through an amended return, administrative adjustment request or a Form 3115.

INCREASE CASH FLOW AND OPPORTUNITIES WITH A COST SEGREGATION STUDY

Cost segregation identifies parts of a building that can be depreciated more quickly and turns those components into bigger tax deductions that can generate more cash flow in the earlier years of a building's lifespan. These studies can be applied to current year construction, renovations and purchases, as well as prior years through a look-back study. With the bonus depreciation rate set to decrease by 20 percent at the end of 2022, now is the time to take advantage of cost segregation.

If you're considering cost segregation, here are some things to keep in mind:

- **Impact of net operating losses:** A net operating loss (NOL) is an excess of deductions over income from the operation of a business. In tax year 2021 and beyond, NOLs are limited to 80 percent of taxable income and can be carried forward indefinitely. Taxpayers no longer have the carry back option. Your RKL advisor can help you assess the impact of passive loss rules in the context of your organization's planned holding period and timing.
- **New and used property:** Cost segregation now applies to new and used property (after 9/27/2017), which means that owners can take advantage of bonus depreciation on qualifying assets identified at the time of a building's purchase.
- **Time value of money:** Cost segregation is a timing issue. Business owners receive the same amount of depreciation on an asset whether or not cost segregation is performed. The value of cost segregation is recognizing more depreciation deductions in the earlier years and generating cash flow when you need it.

	Description	100% Bonus Depreciation Eligibility	Qualified Improvement Property (QIP) Eligibility	Accounting Method Change Required
Purchase Price Allocations	Break out of purchase price into land, building, land improvements and personal property	Yes (land improvements and personal property)	No	No
New Construction	Segregate cost of construction project to break out land improvements and personal property	Yes (land improvements and personal property)	No	No
Renovations	Segregate cost of construction project to break out land improvements, personal property and QIP	Yes (land improvements, personal property and QIP)	Yes	No
Look-Back Studies	Segregate assets from prior year purchase or construction project to break out land improvements, personal property and QIP	Depends upon the year of purchase/ construction and the bonus depreciation rules at that time	Purchases — No Construction — Depends upon year in which construction occurred	Yes

Fixed Asset Planning (continued)

SEE HOW COST SEGREGATION BENEFITS ORGANIZATIONS LIKE YOURS

Equipment Purchase

Client A purchases a piece of manufacturing equipment for $25,000 in 2022. The equipment is personal property with a class life of 20 years or less. Since the acquisition and in-service dates are after September 27, 2017, it is eligible for 100 percent bonus depreciation. This means that the total purchase price will be fully depreciated in the year of purchase for federal tax purposes. Please note that most states do not recognize bonus depreciation. Depending on the facts and circumstances, Section 179 may also be an option for immediate write-off.

Purchase Price Allocation

Client B purchased an office building in 2022 for $1.5 million. Assume RKL identifies 20 percent, or $300,000, of the purchase as personal property and land improvements through cost segregation. Combined with 100 percent bonus depreciation, the cost segregation study results in additional depreciation deductions of $296,000 for a tax savings of $109,500 using tax rate of federal 37 percent.

Renovations

Client C renovated the interior space of an office building in 2022 for $150,000. Because the renovations were interior improvements with no footprint expansion, the qualified improvement property (QIP) tax strategy may be applicable. Assume RKL is able to identify 95 percent, or $142,500, of the total project cost as personal property and qualified improvement property. Combined with 100 percent bonus depreciation, this cost segregation produces additional depreciation deductions of $141,000 for a tax savings of $52,000 using a federal tax rate of 37 percent.

Ready to get tax savings from your fixed asset investments? Contact your **RKL advisor** or Deb Rock, Cost Segregation Practice Leader, at **derock@rklcpa.com**.

R&D Update: New IRS Requirements for Filing Tax Credit Refunds

Did you know there is a tax-savings opportunity for the domestic product development and process improvement activities you're likely already undertaking? The research and development (R&D) tax credit was enacted in 1981 to incentivize U.S. business innovation and investment. In essence, eligible R&D expenses include employee time, material and outside services spent on qualified research projects. Since 2015, this credit is permanently available to even more companies, including smaller or newer businesses.

Most recently, the IRS released a memorandum to clarify what material is relevant to R&D credit refunds claimed via amended tax returns. This guidance is effective for claims filed since January 10, 2022, with a one-year transition period to allow taxpayers 45 days to perfect an R&D refund claim lacking the newly required materials (listed below).

The IRS now requires taxpayers to provide the following information along with an R&D refund claim:

1. Identification of all business components related to the R&D credit for the claim year
2. All research activities performed by each business component
3. All individuals who performed each research activity within each business component
4. All the information each individual sought to discover, broken out by business component
5. Total qualified employee wage expenses, total qualified supply expenses and total qualified contract research expenses for the claim year

Failure to include all of the required information may lead to IRS rejection of the refund claim.

Need help documenting and claiming R&D credits? Contact your **RKL advisor** or Ben Fortner, Partner and R&D Credit Practice Leader, at **bfortner@rklcpa.com**.

IRS 2022 CLARIFICATION

For taxpayers who claimed the Employee Retention Tax Credit (ERTC), wages used to calculate their 2021 ERTC must be excluded from any R&D credit calculation.

LOOKING AHEAD ›

While the IRS is currently requiring this additional documentation for refund claims only, this information may also be required for originally filed R&D tax credits in the future. The RKL team can advise on documentation processes and procedures in support of any R&D credit claim — contact our practice leader listed on this page.

U.S. International Tax Compliance

Over the past five years, the Treasury Department and IRS have slowly released regulations (many of them retroactive) to clarify tax reform's major international changes. We have gained and continue to gain additional insights into key areas outlined below.

INCREASED REPORTING REQUIREMENTS

To keep up with complexities of U.S. international tax law, informational reporting for U.S. taxpayers with ownership in foreign corporations increased dramatically. This additional data is required to be included with the tax return of a "U.S. Shareholder," which is defined as a domestic individual or entity with a 10 percent ownership interest in a controlled foreign corporation (CFC). A CFC is a foreign corporation with more than a 50 percent share (by vote or value) owned by 10 percent U.S. Shareholders.

COMPLIANCE TIPS ›

- Allow sufficient time to gather the new documentation and potentially coordinate with other shareholders to get a complete picture of the earnings subject to tax.
- The 10 percent ownership interest threshold for determining status as a U.S. Shareholder is not applicable for ownership in captive insurance companies. In that case, any ownership share automatically causes a U.S. person to be a U.S. Shareholder.

Expansion of Foreign Reporting:

- Forms K-2 and K-3 are designed to report items of international relevance to partners and shareholders of pass-through entities.
- Schedule Q of Form 5471 discloses CFC income and deductions broken out by income category.
- Schedule R of Form 5471 discloses information on distributions from a foreign corporation.
- Detailed questionnaires regarding payments to foreign persons, foreign-derived sales, inversions, intercompany arrangements and other transactions provide a roadmap for the IRS to identify relevant international tax concerns.
- Foreign tax payment support information including the amount of income taxable on the foreign tax return, foreign currency and breakdown of taxes applied to various U.S. anti-deferral categories and buckets of earnings.
- Supporting data relating to the calculation of Global Intangible Low-Taxed Income (GILTI).
- Breakdown of the foreign corporation's earnings and profits (E&P) into various categories and E&P buckets, along with additional detail by shareholder for amounts previously taxed under one of the anti-deferral regimes.

FOREIGN TAX CREDITS NOW REQUIRE ATTRIBUTION

On December 28, 2021, the IRS released final regulations regarding the foreign tax credit, which includes a new attribution requirement in determining what qualifies as a creditable foreign tax. U.S. taxpayers who have historically taken advantage of the credit will need to reevaluate their ability to take a credit for foreign taxes paid to relevant jurisdictions and ensure the new attribution requirements are met.

EXPANDED INTERNATIONAL TAX REPORTING THROUGH SCHEDULES K-2 AND K-3

In the 2021 tax year, the IRS expanded international tax reporting requirements of pass-through entities with the release of the new Schedule K-2 and Schedule K-3. Many domestic partnerships, S Corporations and foreign partnerships will need to complete these schedules to report items of international tax relevance, whether or not they have foreign activities.

Schedule K-2 provides pass-through entities with a standardized format to summarize and present international tax information to their owners through expanded detail of foreign income, deductions, withholdings and foreign taxes paid.

Schedule K-3 provides owners with more clarity on their relevant international tax items to assist in the calculation of the foreign tax credit and computing their U.S. income tax liability.

Pass-through entities with foreign activity should reach out to their **RKL advisor** to determine whether they are required to file these new schedules or can take advantage of the 2021 exceptions from filing.

Have questions about the tax impact of your company's cross-border activities? Contact your **RKL advisor** or Kirsten Deeds, International Tax Practice Leader, at **ktdeeds@rklcpa.com**.

GLOBAL INTANGIBLE LOW-TAXED INCOME

The Tax Cuts and Job Act (TCJA) created a provision that applies a minimum tax on the income earned by a controlled foreign corporation (CFC) above a 10 percent return on its depreciable tangible property used to generate income. This is commonly referred to as GILTI.

GILTI allows for:

- A limited exception to partners based on ownership tests at the partner and CFC level
- A high-tax exclusion if the effective tax rate on GILTI income exceeds 18.9 percent and an appropriate election is made with the tax return

FOREIGN-DERIVED INTANGIBLE INCOME

For C Corporations only, a tax benefit may be available on the export of goods and services for use in a foreign country. If export profits exceed a calculated tangible property-related profit, the company will generally be eligible for a deduction for foreign-derived intangible income (FDII).

IC-DISC OPPORTUNITIES

Interest Charge Domestic International Sales Corporation (IC-DISC) can be beneficial to producers who directly export products or sell products to wholesalers or distributors who resell outside of the U.S. IC-DISCs provide significant and permanent tax savings by creating a separate entity that is exempt from federal income tax. Operating entities pay a tax-deductible commission to the IC-DISC, which in turn pays a dividend at a tax-favorable rate.

FOREIGN DIVIDEND PLANNING

Tax reform's new foreign income inclusions have an upside: tax-free repatriation of cash. To the extent that foreign earnings are subject to tax, the equivalent amount may generally be distributed to U.S. shareholders without being taxed a second time. For U.S. C Corporations, an even more generous 100 percent dividends received deduction is allowed against dividends from 10 percent-owned foreign corporations.

THE TRANSITION TAX LIVES ON

The Section 965 transition tax represented a mandatory deemed repatriation of the accumulated earnings of foreign corporations with U.S. ownership. Taxpayers generally reported the 965 liability and reporting on 2017 and 2018 tax returns. Looking forward, only those taxpayers who elected to pay the tax in installments will have continued 965 reporting requirements. In addition to penalties, failure to make a timely installment payment according to the below schedule can trigger acceleration and immediate payment of the entire tax liability.

8 PERCENT of the tax liability for each of the first five installments

15 PERCENT of the tax liability for the sixth installment

20 PERCENT of the tax liability for the seventh installment

25 PERCENT of the tax liability for the eighth installment

FOREIGN PARTNER REPORTING AND WITHHOLDING

When a partnership has foreign partners, expanded reporting and withholding may be required. If the partnership has effectively connected income (ECI) tied to the partnerships business activities, it must withhold on the ECI allocable to the foreign partners. The default withholding rate for foreign corporate partners is 21 percent, and the rate for foreign non-corporate partners is 37 percent. The withholding tax liability of the partnership is reported annually on Form 8804. Additionally, quarterly estimates are required throughout the year and are remitted using Form 8813.

STATE TAX IMPLICATIONS

For many foreign companies with sales and distribution activities within various states, it may come as a surprise that even those with no physical presence in the U.S. can have significant state tax compliance responsibilities. For federal tax purposes, non-U.S. companies can rely on existing income tax treaties to reduce or eliminate the federal income tax liability. However, these federal treaties do not apply at the state level, leaving companies exposed, especially those with a physical presence in the state (i.e., property or payroll). Depending on your facts and the state, a non-U.S. company even with no physical presence in the U.S. might be subject to a state's income tax, franchise tax based on net worth, gross receipts tax or a requirement to collect sales tax from customers and remit it to the state.

U.S. International Tax Compliance (continued)

REPORTING FOR PAYMENTS TO FOREIGN PERSONS

Taxpayers who conduct business with foreign vendors and foreign related parties must report payments and withhold tax from certain types of income. The rules for withholding tax on payments of U.S. income earned by foreign persons can be quite complex and missing a tax deposit during the year can be costly. Remember:

- Forms 1042, 1042-S and 1042-T (which summarize yearly withholdings) are due each year on March 15.
- Tax withholding generally applies to income that is passive in nature, such as interest, dividends, rents, royalties (including items deemed to be royalties, such as software subscriptions), premiums and annuities. Services performed in the U.S. can also be subject to withholding.
- When doing business with a foreign payee, make sure to receive a completed Form W-8, which certifies a foreign person's tax status.
- Form W-8s are valid starting on the date of signature and ending on the last day of the third succeeding calendar year. Exceptions apply when a change in circumstance invalidates any information presented on the current form.
- Interest charges apply to late deposits and late payment penalties can reach as high as 25 percent of the unpaid tax in some cases. If annual Form 1042 filings are missed, late filing penalties up to another 25 percent of the tax can result.
- Even if the default withholding rate is reduced to zero, there is still a requirement to file Form 1042.

How to Identify Payments to Foreign Persons

1. Review vendor list for non-U.S. payees, passive payments and services performed in the U.S. by a foreign person or company (exclude inventory and equipment purposes).
2. Require completion of Form W-9 (for domestic payees) and Form W-8 (for foreign payees) as part of vendor acceptance process to reduce potential tax or penalty exposure.
3. Withhold tax at time of payment and deposit to the U.S. Treasury within three business days after the end of the quarter-monthly period in which the payment is made to the foreign party.
4. Stay in contact with **your RKL advisor** as payments are made in real time to prevent issues down the line and ensure compliance.

Let’s Continue **the Conversation ›**

This publication is intended to guide our clients and friends through year-end planning and facilitate discussion around new tactics or opportunities.

Questions about any of the topics discussed here? Ready to implement any of these strategies?

Contact your RKL advisor, reach out to one of the specialty tax practice leaders listed throughout the guide or visit **RKLcpa.com/contact**.

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