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THE EMPLOYEE RETENTION CREDIT AND AMERICAN FAMILIES PLAN WEBINAR

Thursday, May 27, 2021

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May 27, 2021

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AGENDA

- Update on Employee Retention Credit (ERC)
- Overview of Proposed American Families Plan (AFP)
- Other COVID-19 Developments
- Questions

EMPLOYEE RETENTION CREDIT (ERC)

- Overview of ERC (CARES 1 & CARES 2)
- Changes to ERC in American Rescue Plan (ARP or CARES 3)
- Comparison of ERC and PPP Loan
- Interaction of ERC with PPP Loan
- Capturing and Claiming ERC Benefits

OVERVIEW OF EMPLOYEE RETENTION CREDIT (ERC)

OVERVIEW OF EMPLOYEE RETENTION CREDIT (ERC)

Provides incentive to employers impacted by COVID-19

4-Step Process - Sikich Flow Chart

- **#1 - ERC Affiliation Rules**
- **#2 - ERC Eligibility**
  - **Significant Decline in Gross Receipts**; or
  - **Full or Partial Shutdown** of business from a Government Order
- **#3 - Small Employer or Large Employer**
  - Small Employer based on number of employees depending on year:
  - For 2020 ≤ **100 Employees**
  - For 2021 ≤ **500 Employees**
- **#4 – Determine Eligible ERC Wages and Calculate ERC**
  - 2020: $10,000 per employee per year **(50% credit)**
  - 2021: $10,000 per employee per quarter **(70% credit)**

OVERVIEW OF EMPLOYEE RETENTION CREDIT (ERC)

ERC Affiliations Rules – Significance of Aggregation (Step #1)

- Businesses required to be aggregated are treated as a single employer for purposes of the following ERC rules:
  1. **Determining whether the employer has a trade or business operation that was fully or partially suspended due to orders related to COVID-19 from an appropriate governmental authority;**
  2. **Determining whether the employer experiences a significant decline in gross receipts;**
  3. **Determining whether the employer averaged more than 100 full-time employees;**
  4. **Determining the maximum credit amount per employee.**

OVERVIEW OF EMPLOYEE RETENTION CREDIT (ERC)

Eligible/Qualified Employer for ERC (Step #2):

- **Must be Carrying on a Trade or Business during 2020 and/or 2021.** Includes exempt orgs under §501(a) – these are deemed to be engaged in a "trade or business" with respect to all operations of the exempt org.
- **AND,** Must Satisfy One of these Two Tests:
  - **Significant decline in gross receipts OR**
  - **Fully or partially suspended** operations during the calendar quarter due to **orders** from an appropriate **governmental authority** limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19.

OVERVIEW OF EMPLOYEE RETENTION CREDIT (ERC)

ERC Eligibility

- **2020 ERC: Significant decline (> 50%) in gross receipts:**
  - (1) beginning with the first calendar quarter after December 31, 2019; and
  - (2) ending with the calendar quarter where revenues are > 80% of the revenues for the prior calendar quarter.
- **2021 ERC: Significant decline (> 20%) in gross receipts:**
  - (1) Compare current year 2021 quarter to 2019 corresponding quarter; OR
  - (2) Compare immediately preceding quarter to 2019 corresponding quarter ("alternative quarter election").

OVERVIEW OF EMPLOYEE RETENTION CREDIT (ERC) – ERC ELIGIBILITY

ERC Chart for Comparison of Gross Receipts (> 50% for 2020; > 20% for 2021)

Employer Eligible	Comparison of Calendar Quarters
2020 Qtr 1	2020 Qtr 1 vs. 2019 Qtr 1
2020 Qtr 2	2020 Qtr 2 vs. 2019 Qtr 2
2020 Qtr 3	2020 Qtr 3 vs. 2019 Qtr 3
2020 Qtr 4	2020 Qtr 4 vs. 2019 Qtr 4
2021 Qtr 1	2021 Qtr 1 vs. 2019 Qtr 1; OR 2020 Qtr 4 vs. 2019 Qtr 4
2021 Qtr 2	2021 Qtr 2 vs. 2019 Qtr 2; OR 2021 Qtr 1 vs. 2019 Qtr 1
2021 Qtr 3	2021 Qtr 3 vs. 2019 Qtr 3; OR 2021 Qtr 2 vs. 2019 Qtr 2
2021 Qtr 4	2021 Qtr 4 vs. 2019 Qtr 4; OR 2021 Qtr 3 vs. 2019 Qtr 3

OVERVIEW OF EMPLOYEE RETENTION CREDIT (ERC) - ERC ELIGIBILITY – 2020

- **Significant Decline in Gross Receipts > 50%**
  - What if **first quarter** business has a **more than 50% decline** in gross receipts? ERC for this quarter. **Not just 50% drop; but > 50% drop. Rules follow Section 448(c).**
  - What if the **first quarter** quarterly gross receipts come back to > 80% of what they were for 2019? **ERC still counts for this quarter.** Thus, no ERC for the quarter **following** the quarter where greater than 80% threshold is met.

ERC - Example 1:		
Q2 2019 = $100,000	Q2 2020 = $45,000	55% ↓ ERC for this quarter (Start)
Q3 2019 = $100,000	Q3 2020 = $75,000	75% PY - ERC for this quarter
Q4 2019 = $100,000	Q4 2020 = $81,000	81% PY - ERC for this quarter (End)

OVERVIEW OF EMPLOYEE RETENTION CREDIT (ERC) - ERC ELIGIBILITY – 2020

- Significant Decline in Gross Receipts > 50%

ERC - Example 2:		
Q2 2019 = $100,000	Q2 2020 = $45,000	55% ↓ ERC for this quarter (Start)
Q3 2019 = $100,000	Q3 2020 = $81,000	81% PY - ERC for this quarter (End)
Q4 2019 = $100,000	Q4 2020 = $81,000	No ERC for this quarter

ERC - Example 3:		
Q2 2019 = $100,000	Q2 2020 = $45,000	55% ↓ ERC for this quarter (Start)
Q3 2019 = $100,000	Q3 2020 = $81,000	81% ERC for this quarter (End)
Q4 2019 = $100,000	Q4 2020 = $45,000	55% ↓ No ERC for this quarter? (2nd time > 50% drop)

OVERVIEW OF EMPLOYEE RETENTION CREDIT (ERC)- ERC ELIGIBILITY – 2021

- Significant Decline in Gross Receipts > 20%

ERC - Example 4:		
Q1 2019 = $100,000	Q1 2021 = $81,000	19% ↓ Q1 2021: No, ERC
Q2 2019 = $100,000	Q2 2021 = $79,000	21% ↓ Q2 2021: Yes, ERC
Q3 2019 = $100,000	Q3 2021 = $81,000	21% ↓ Q3 2021: No, ERC

ERC - Example 5: With “Alternative Quarter Election”:		
Q4 2019 = $100,000	Q4 2020 = $79,000	21% ↓ Q1 2021: Yes, ERC
Q1 2019 = $100,000	Q1 2021 = $81,000	19% ↓ Q2 2021: N/A (met above)
Q2 2019 = $100,000	Q2 2020 = $79,000	21% ↓ Q3 2021: Yes, ERC

- Summary: ALL Three Quarters would be eligible for 2021 ERC!

OVERVIEW OF EMPLOYEE RETENTION CREDIT (ERC) - ERC ELIGIBILITY

Partial or Full Suspension in Operations

- What does this mean?
- Congressional intent not well documented
- Legal interpretations. State, county, city, and other municipalities across the US have issued orders. Various terms. Consider obtaining a legal opinion.
- Government order has a "more than nominal impact." For example, elective surgeries disallowed or limit capacity or number of customers in bars or restaurants.
- Can be indirect – supplier or key vendor is subject to an order, which causes adverse impact on your business.
- Facts and Circumstances Analysis.
- We now have Notice 2021-20

IRS GUIDANCE ON ERC

- **IRS Notice 2021-20**. Addresses ERC changes made by CAA for 2020, and interaction of PPP loan and ERC. **March 1, 2021**.
- 71 Qs (102 pages) included in Notice.
- Provides authority now for taxpayers and practitioners to rely on.
- Key Takeaways from IRS Notice 2021-20:
  - Meaning of "nominal;" provides for a safe harbor
  - Meaning of "comparable"
  - Interaction with PPP
  - Treatment of income tax deduction for ERC
- **IRS Notice 2021-23.** Address ERC changes made by CAA that impact 2021 (through 6/30/2021). Provides additional guidance. **April 2, 2021.**
- IRS indicated it would provide further guidance related to ERC changes made by American Rescue Plan (ARP).

OVERVIEW OF EMPLOYEE RETENTION CREDIT (ERC) - ERC ELIGIBILITY

Test 1: More than Nominal Size Test (Suspended Operations)

- A suspension of some portion of your business operations.
- Evaluate relative size using 2019 quarterly revenues or hours (specific metric).
- **Safe Harbor of 10%,** but facts and circumstances could allow for a lower %.
- If more than nominal, then entire business would be eligible for ERC.
- See **Q #11 (Notice 2021-20).**

OVERVIEW OF EMPLOYEE RETENTION CREDIT (ERC) - ERC ELIGIBILITY

- **Test 2: More than Nominal Effect Test (Continuing Operations)**
  - Even if you fail the suspended operations test, can still be considered partially suspended
  - Some restrictions in effect due to government orders
  - Do they restrict or limit the business enough? Facts & Circumstances.
  - New Test: Reduction of ability to provide goods or services (does not contain metrics like revenues or hours).
  - Factors that **will not have a more than nominal effect on the operations**: Customer mask requirements; one-way aisles; requiring employees to wear masks and gloves.
  - See also **Qs #17 and #18 (Notice 2021-20).**

OVERVIEW OF EMPLOYEE RETENTION CREDIT (ERC) – ERC ELIGIBILITY

- Small Employer or Large Employer (**Step #3**)
- For 2020, small employer described as one with ≤ 100 employees
- For 2021, small employer described as one with ≤ 500 employees
- Use ACA Rules for FTEs to determine # of employees. Employer Size FT =30 hours/week; or 130 hours/month. [Section 4980H]
- Wage Period if "Significant Decline in Gross Receipts" met = entire quarter
- Wage Period if "Government Order" met = period of shutdown
- **If small employer**, then ALL WAGES paid to employee qualify for ERC whether employee is working or not
- **If large employer,** then only wages paid to employee for NOT WORKING qualify for ERC.

OVERVIEW OF EMPLOYEE RETENTION CREDIT (ERC) – ERC ELIGIBILITY

Determine Eligible ERC Wages and Calculate ERC (Step #4)

- Determined quarterly
- **For 2020**, $10,000 of wages per employee per year. **50% factor.** Max Credit is $5,000 per employee per year.
- **For 2021,** $10,000 of wages per employee per quarter. **70% factor.** Max Credit is $7,000 per employee per quarter, or $28,000 for year.

OVERVIEW OF EMPLOYEE RETENTION CREDIT (ERC) – ERC ELIGIBILITY

Determine Eligible ERC Wages and Calculate ERC

Qualified Wage Items for ERC:

- Employer health insurance counts as ERC wages.
- Self-employed earnings are **not** qualified wages.
- Qualified Family Leave or Sick Leave (FFCRA) wages are **not** ERC wages.
- **Wages paid to certain family members don't count**. Individual owner and spouse are not mentioned in FAQ #59. Section 51(i) describes ineligible family members and related parties. But if own more than 50% then ineligible under IRC 267(c)

POLL QUESTION

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CHANGES TO ERC IN AMERICAN RESCUE PLAN (ARP OR CARES 3)

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CHANGES TO ERC IN AMERICAN RESCUE PLAN (ARP OR CARES 3)

- Enacted March 11, 2021
- ERC extended through December 31, 2021
- Added new ERC feature for start-up businesses (3rd and 4th quarter 2021 only)
- Also, added another ERC feature for severely distressed businesses (90% decline in gross receipts) 3rd and 4th quarter 2021 only
- IRS can audit and issue assessments for a period of five years instead of normal 3 years

COMPARISON OF ERC AND PPP LOAN

COMPARISON OF ERC AND PPP LOAN

- Both available now for 2020 and 2021
- PPP loan capped at $10 million (Draw 1) and $2 million (Draw 2)
- No cap for ERC. Small employer max of $500,000 in 2020, and $14 million in 2021. Large employer could possibly go higher, but limited as only receive ERC for paying employees NOT to work
- PPP loan obtained through bank and administered by SBA
- **ERC is refundable payroll tax credit governed by IRS**
- PPP loan can be forgiven, and no tax owed on debt relief
- **ERC treated as taxable income**
- PPP Loan (Draw 1 & Draw 2) and ERC (2020 & 2021) Sikich Comparison Chart

INTERACTION OF ERC WITH PPP LOAN

INTERACTION OF ERC AND PPP LOAN

- Both PPP Loan and ERC available in 2020 and 2021
- IRS Guidance on ERC. IRS Notice 2021-20. See Question #49.
- IRS includes seven useful examples on the interaction of wages for PPP loans and ERC purposes.

ERC EXAMPLES
FROM IRS NOTICE 2021-20 Q#49

(Example 1). Employer A received a PPP loan of $100,000. Employer A is an eligible employer and paid $100,000 in qualified wages that would qualify for the ERC during Q2 and Q3 of 2020. To receive forgiveness of its entire PPP loan, Employer A was required, under SBA rules, to report a total of $100,000 of payroll costs and other eligible expenses (≥ $60,000 of payroll costs).

Employer A submitted a PPP Loan Forgiveness Application and reported $100,000 of qualified wages as payroll costs in support of forgiveness of its entire PPP loan. Employer A received a decision from the SBA in the first quarter of 2021 for forgiveness of its entire $100,000 PPP loan amount.

Employer A is deemed to have made an election not to take into account $100,000 of the qualified wages for ERC purposes, which was amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application. This was sufficient to support the amount of the PPP loan that is forgiven. **Employer A may not treat that amount as qualified wages for ERC purposes.**

ERC EXAMPLES

(Example 2). Employer B received a PPP loan of $200,000. Employer B is an eligible employer and paid $250,000 of qualified wages that would qualify for the ERC during Q2 and Q3 of 2020. To receive forgiveness of its entire PPP loan, Employer B was required, under SBA rules, to report a total of $200,000 of payroll costs and other eligible expenses (≥ $120,000 of payroll costs). Employer B submitted a PPP Loan Forgiveness Application and reported the $250,000 of qualified wages as payroll costs in support of forgiveness of the entire PPP loan. Employer B received a decision from the SBA in Q1 of 2021 for forgiveness of the entire $200,000 PPP loan.

Employer B is deemed to have made an election not to take into account $200,000 of the qualified wages for ERC purposes, which was amount of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application. It may not treat that $200,000 as qualified wages for ERC purposes. Employer B is not treated as making a deemed election with respect to $50,000 of the qualified wages ($250,000 reported on the PPP Loan Forgiveness Application, minus $200,000 reported on the PPP Loan Forgiveness Application up to entire loan forgiveness), **and it may treat that $50,000 amount as qualified wages for ERC purposes.**

ERC EXAMPLES

(Example 3). Employer C received a PPP loan of $200,000. Employer C is an eligible employer and paid $200,000 of qualified wages that would qualify for ERC for Q2 and Q3 of 2020. Employer C also paid other eligible expenses of $70,000. In order to receive forgiveness of its entire PPP loan, Employer C was required, under the SBA rules, to report a total of $200,000 of payroll costs and other eligible expenses (≥ $120,000 of payroll costs). Employer C submitted a PPP Loan Forgiveness Application and reported $200,000 of qualified wages as payroll costs in support of forgiveness of the entire PPP loan, **but did not report the other eligible expenses of $70,000**. Employer C decision from the SBA in Q1 of 2021 for forgiveness of its entire $200,000 PPP loan amount.

Employer C is deemed to make an election not to take into account $200,000 of qualified wages for ERC purposes, which was amount of qualified wages included as payroll costs reported on its PPP Loan Forgiveness Application. Although Employer C could have reported $70,000 of eligible expenses (other than payroll costs) and $130,000 of payroll costs, Employer C reported $200,000 of qualified wages as payroll costs on its PPP Loan Forgiveness Application. As a result, no portion of those qualified wages reported as payroll costs may be treated as qualified wages for ERC purposes. **Employer C cannot reduce the deemed election by the amount of the other eligible expenses that it could have reported on its PPP Loan Forgiveness Application.**

ERC EXAMPLES

(Example 4). Same as Example 4, except Employer C submitted a PPP Loan Forgiveness Application and **reported** the $200,000 of qualified wages as payroll costs, as well as **$70,000 of other eligible expenses**, in support of forgiveness of its PPP loan. Employer C received a decision by the SBA in Q1 of 2021 of forgiveness of its entire $200,000 PPP loan. In this case, Employer C is deemed to have made an election not to take into account $130,000 of qualified wages for ERC purposes, which was amount of qualified wages included in the payroll costs reported on its PPP Loan Forgiveness Application. **As a result, $70,000 of the qualified wages reported as payroll costs may be treated as qualified wages for ERC purposes.**

POLL QUESTION

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CAPTURING AND CLAIMING ERC BENEFITS

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CAPTURING AND CLAIMING ERC BENEFITS

- ERC claimed on Company's payroll tax return (not income tax return).
- Can claim on quarterly **Form 941** filing during 2021.
- Can also claim on amended payroll tax filings on **Form 941-X** for both 2020 and 2021.
- ERC can offset Company's payroll tax obligations. If ERC exceeds Company's tax on its From 941, then excess can be **REFUNDED** to Company. Can also file IRS **Form 7200 to try to get refund quicker**.
- See **Qs #50 - #58** in IRS Notice 2021-20.
- **ERC Substantiation. See also Qs #70 - #71.** Maintain records for at least four years after tax due or paid (whichever is later).

FORM 941 AND 941-X

- New draft Form 941 released yesterday morning, May 26th.
  - New line for Form 7200 advances received, line 13h
- No ability yet to file a Form 941-X electronically (claim for refund)
- Sch B should match line 12 of Form 941. It is NOT the deposits made.
- Some still mail their Form 941's (printing from the software) vs. electronically filing Form 941
- Timeline for refunds?

FORM 7200 AND INSTRUCTIONS

- Remember can only be used by small employers now (2021 ERC).
- New form and instructions released in May (April revision). Make sure you are using the April 2021 version of the Form.
- "It's possible that the Form 7200 may <u>not</u> be processed prior to the processing of the filed Form 941 for the quarter"
- "Advance payment requests on Form 7200 for a quarter won't be paid after your Form 941 has been processed for that quarter"
- "We will correct the amount reported on Form 941 to match the amount of advance payments issued or contact you to reconcile the difference if we finish processing Form 941."
- Form is able to be faxed – 855-248-0552
- Last day to file Form 7200 for the second quarter is August 2, 2021.

AMERICAN FAMILIES PLAN (AFP)

AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

- "Family Infrastructure." Spending plan for individuals and families.
- Separate from physical infrastructure proposal in "American Jobs Plan" of revised ~ $1.7 trillion paid for with tax hikes on businesses.
- Overall ~ $1.8 trillion plan in AFP, consisting of $1.0 trillion of "investments" to assist workers (pre-school education, free college program; nutrition; and others) and $0.8 trillion for tax credits for families (enhanced child credit; extended child-care credits/assistance; earned income tax credit; and more).
- Paid for with additional individual income taxes of ~ $1.6 trillion.
- Several significant proposed changes in AFP, but other items left out.

AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

Items INCLUDED in AFP:

- Higher individual tax rates. Undo some TCJA tax reductions.
- Higher tax on capital gains and dividends.
- No step-up in basis at death for appreciated property.
- Like-kind exchanges limited.
- Large loss limitation made permanent.
- Apply 3.8% NIIT tax on all income over $400,000. Remove exception available now for those involved in the business.
- Additional resources for IRS enforcement (audits) and compliance.

AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

Items EXCLUDED from AFP:

- Limitation on itemized deductions
- Limitation on 20% “Qualified Business Income Deduction” (Section 199A)
- Higher payroll taxes
- Higher estate taxes
- Trigger gain of appreciated assets at death
- Wealth tax
- Remove/soften TCJA $10,000 limitation on SALT deduction
- **Note:** While these items were not part of AFP, any of these could still be introduced by Congress, or part of other proposals.

AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

Higher Individual Tax Rates

- Undo lower rates enacted by TCJA
- Top Rate dropped by TCJA from 39.6% to 37%.
- AFP would increase top rate back to 39.6%.
- Current 37% rate begins with taxable income of $550,000 (MFJ), and $400,000 (Single).
- Unsure what income levels the "new" 39.6% rate would begin.

AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

Higher Tax On Capital Gains and Dividends

- Current top tax rate is 20% plus 3.8% NIIT tax results in 23.8% rate.
- Applies to long-term capital gains and qualified dividends.
- Nearly doubles the tax rate by **treating Capital Gains/Dividends as ordinary income** and taxed at 39.6% for taxpayers with income with ≥ $1,000,000. With the 3.8% NIIT tax, the rate climbs to 43.4%.
- Significant impact with investing and tax planning.

AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

No Step-up in Basis at Death for Appreciated Property

- Under current law, property receives step-up in basis to its FMV at the date of death.
- Heirs will not incur any capital gains tax upon disposal of property received at death.
- Long-standing rule. Key aspect in estate planning.
- $1,000,000 exemption provided.
- Also, AFP would include "protections" so a family-owned business and farm would not incur a capital gains tax when business/farm transferred to heirs who continue to run business/farm. Unclear what this would involve.

AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

Like-Kind Exchanges Limited

- Under current law, real property can be exchanged without recognizing gain if certain rules met. No longer available for personal property (TCJA).
- Replacement property must be: (1) identified ≤ 45 days after disposal of relinquished property; and (2) acquired generally within ≤ 180 days after disposal of relinquished property.
- Gain is "deferred," not permanently excluded, by substituting basis of disposed property to replacement property.
- AFP would limit like-kind exchanges to **$500,000.**
- Unsure of details on $500,000 limitation. Per disposal? Per year? Etc.

AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

Large Loss Limitation Made Permanent

- For tax years 2021 through 2026, taxpayer's deduction for losses limited to $500,000 per year. Excess losses carried forward.
- Loss limitation applied after all other loss limitations.
- AFP would make this $500,000 loss limitation permanent.

AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

3.8% NIIT Tax (Medicare) Applies to All Types of Income

- The 3.8% Medicare tax presently applies to some, but not all, businesses.
- AFP would apply this 3.8% Medicare tax consistently to those making over $400,000, ensuring that all high-income taxpayers pay the same 3.8% Medicare tax.
- Would still have a discrepancy, but only for those making less than $400,000.

AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

Additional Resources for IRS Enforcement (Audits) and Compliance

- $700 billion, about half of projected AFP tax revenue, from this IRS enforcement provision.
- Generated from more audits of higher income taxpayers, but could fall on taxpayers earning < $400,000.
- Focused on several areas, including pass-through entities (S Corporations and Partnerships/LLCs); foreign activities; trusts; and other areas.

AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

Additional Resources for IRS Enforcement (Audits) and Compliance (continued)

- Expanded focus on crypto-currency reporting.
- Enhanced reporting and matching/reconciliation forms. IRS might seek all bank records of taxpayers and reconcile these to amounts reported on tax returns.
- Based partly on studies of “Tax Gap” and apparent significant level of unreported income.
- Expectation that extra enforcement will reel in additional tax revenue. Comes with added reporting and record-keeping burden on already compliant taxpayers.

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AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

Legislative Considerations with AFP

- Bill is just a proposal now. Must navigate through Congress.
- Congress will develop and promote its own bill which might differ from administration’s proposal.
- Leaders will try to craft bill that can survive the razor-thin margins in House and Senate. The administration will likely accept any bill that passes through Congress.
- Uncertain if “budget reconciliation” will be used for AFP. If not, 60 votes will be needed in Senate.
- Passage of bill unclear at this point, as are particular details of plan.
- Also, uncertain are the effective dates of these changes.

AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

Practical and Planning Observations with AFP

- **(#1) Entity Selection.** Besides AFP, American Jobs Plan includes hike in corporate tax rate from 21% to 25-28%. Chart compares corporate tax rates vs. pass-throughs rates (S Corp-Partnership). Includes 20% QBI deduction and proposed NIIT tax changes:

	Corporate Tax	Individual Tax	Total Tax
#1 - Current C Corp	21.00%	18.80%	39.80%
#2 - Current Pass-thru (No QBI)	-0-	37.00%	37.00%
#3 - Current Pass-thru (QBI)	-0-	29.60%	29.60%
#4 - Proposed C Corp (low divs)	25.00%	17.85%	42.85%
#5 - Proposed C Corp (high divs)	25.00%	32.55%	57.55%
#6 - Proposed Pass-thru (No QBI)	-0-	43.40%	43.40%
#7 - Proposed Pass-thru (QBI)	-0-	35.48%	35.48%

AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

Practical and Planning Observations with AFP

- **(#1) Entity Selection**
- Observations on Proposed New Tax Rates on Entity Selection:

1. Pass-through entity still probably offers better overall option, after considering "double tax" of C Corporation.
2. C Corp with all income paid out as dividends for shareholder with income less than $1,000,000 produces similar results as pass-through that does not qualify for QBI.
3. However, if C Corp pays out dividends to shareholders with income over $1,000,000, then this triggers much higher tax than pass-throughs: ~ 14% higher for pass-through with No 20% QBI deduction; and 22% more than pass-through with 20% QBI deduction.
4. Option producing **lowest current tax cost** is C Corp with No distributions to shareholders. 25% of income applies to tax cost and balance is reinvested in corporation. Double tax deferred in this case.

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AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

Practical and Planning Observations with AFP

- **(#2) Consider accelerating taxable income to lower taxed year.**
    - Determine if beneficial to accelerate taxable income into lower taxed year before tax rates raised in 2021 or 2022. Permanent tax benefit. Compare to present value of paying tax sooner.
    - Could involve changes of accounting method for timing of recognizing income or deductions.
    - Could also elect slower tax depreciation methods rather than bonus deprecation for current CapEx items.
    - Could still be done on extended 2020 tax returns, or for 2021 tax returns. Depends on effective date of any change.
    - Important to model out these proposed changes. Several alternatives to consider, dates, and other factors.

AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

Practical and Planning Observations with AFP

- **(#3) Evaluate Capital Gain Strategies.**
  - **Timing is key.** Could involve accelerating capital gains; or deferring them. First, if planning a sale soon, consider triggering gain to qualify for lower current capital gain rate before higher capital gains rates apply.
  - Once new higher rate kicks in, perhaps defer selling appreciated assets to avoid higher tax (considering market risk).
  - Look at setting up Charitable Remainder Trusts (CRT) and transfer appreciated property to it. Capital gain recognized in CRT, which does not pay tax. Receive payout of reinvested amounts and a charitable deduction.
  - Donate appreciated securities to charity. Avoid larger capital gains tax and obtain FMV charitable deduction. Also, could use Donor Adviser Fund (DAF) or Private Foundation.
  - Consider transferring appreciated securities to investment partnership. Need to follow complex rules and keep in partnership for required period (7+ years) to obtain other securities.

AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

Practical and Planning Observations with AFP

- **(#4) Capital Losses will be more valuable.**
  - If higher taxes on capital gains enacted, capital losses will be worth more.
  - For taxpayers considering "harvesting losses" in underwater securities to offset other capital gains (often done near end of year), consider not harvesting these losses and instead paying capital gains tax at current lower rates. Then, when capital gains rate goes up, sell depressed securities to offset gains taxed at then higher rates. Timing could be critical – monitor effective dates and any transitional rules.

AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

Practical and Planning Observations with AFP

- **(#5) Evaluate Installment Sale Treatment.**
  - Installment sale method has been available for many years. It spreads payment of tax to coincide with installment payments being received.
  - For installment sales occurring in 2020 (and tax return on extension) or in 2021, consider “electing out” of installment method. Analyze amount of capital gain, payment period, etc. Also depends on effective date of capital gain changes.
  - For installment sales originally occurring several years ago and which payments are still being received, consider triggering installment sale by pledging/using installment sale as security for a loan.

AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

Practical and Planning Observations with AFP

- **(#6) Analyze Purging some/all E&P in an S Corporation Rather than its AAA**
  - Generally, distributions from S Corporation (that was previously a C Corporation) to its shareholders are non-taxable up to the amount of its AAA. Any distributions exceeding its AAA are taxable as dividends out of the company's E&P when it was a C Corporation.
  - A special election, however, is available for an S Corporation in this situation. It could elect with consent of all shareholders to have distributions for year to instead be treated as first paid out of E&P and thus taxable to its shareholders, and then next out of AAA. Annual election – made on S Corp tax return.
  - A similar provision is a "deemed election" to treat as paid out of E&P for the year. No cash is actually distributed to shareholder, and amount is treated as contributed back to S Corporation.
    - **Determine amount of AAA and E&P**
    - **Learn effective date of new rate on Capital Gains/Dividends**
    - **Trigger additional tax, but likely at lower current rates, and purge S Corp of its E&P**

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- **(#7) Explore Section 1202 (“Qualified Small Business Stock”).**
  - Taxed as C Corporation with lower rates than a pass-through entity. Thus, provides current cash flow savings.
  - Then if all Section 1202 requirements met, and stock sold after five years, any gain to shareholder is 100% excluded from tax.
  - Also, avoids AMT tax.
  - Qualified Small Business Stock (“QSBS”):
    - Active conduct of trade or business. Generally not service businesses
    - Gross assets of corporation of <$50,000,000
    - Stock acquired at original issue from corporation (i.e., not from another s/h)
    - Stock issued for contribution of cash or other property to corporation
    - Other specific provisions to follow.

AMERICAN FAMILIES PLAN (AFP) - PROPOSAL

Practical and Planning Observations with AFP

- **(#8) Develop New Models for Analysis of M&A Transactions if Seller has Capital Gain taxed at 43.4% [39.6% + 3.8%] instead of 23.8%.**
  - Changes dynamics in asset sale of purchase price allocation with buyer.
  - Seller willing to accept more ordinary income say on M&E and less on intangibles. Both taxed at 39.6% to seller (if higher capital gains tax enacted); but buyer obtains faster write-off of M&E.
  - Also, less concern by seller of “hot assets” in partnership sales.
  - Seller also willing to accept more allocation to compensation since taxed same as capital gain, but buyer obtains current write-off, not 15 years.

OTHER COVID-19 DEVELOPMENTS

OTHER COVID-19 DEVELOPMENTS

- **FFCRA** – sick leave and family leave. Tax credits also available for self-employed individuals. See IRS **Form 7202** and FAQs on IRS Website.
- **Restaurant Revitalization Grant (RRG) Program** – application process with SBA ended this week. Most funds applied for. Funding underway. Unsure if additional funding will be made available by Congress.

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QUESTIONS?

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