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Tax Newsletter

Key Tax Provisions in the New IRA
Tax issues for individuals and businesses

After numerous twists and turns, the **Inflation Reduction Act** (the IRA) was finally signed into law by the president on August 16. Among other aspects, the new law addresses climate control, extends health insurance subsidiaries and permits Medicare to negotiate drug prices. But it also includes the following key tax provisions for individuals and businesses.

Corporate minimum tax: The massive Tax Cuts and Jobs Act (TCJA) imposed a flat tax rate of 21% on corporations, but some corporate heavyweights are able to sidestep the tax. Beginning in 2023, the new law imposes a 15% minimum tax on corporations with average annual adjusted financial statement income above $1 billion for three consecutive tax years. A $100 million threshold applies to certain foreign-backed corporations. Other special rules may come into play.

Stock buybacks: Due to a late addition to the IRA, corporations will be required to pay a 1% excise tax when they purchase their own stock from shareholders. As opposed to corporate dividends, which are currently taxable, stock buybacks result in capital gains that may effectively go untaxed for years or even forever. This new law provision, which takes effect in 2023, reduces the tax advantage.

Energy credits: The new law enhances several tax credits for "going green." Consider these points:

- Buyers of new electric vehicles (EVs) will be eligible for a credit of up to $7,500 for qualified EVs placed in service before 2033. Also, the manufacturer's maximum threshold of 200,000 vehicles sold is eliminated after 2022. But certain high-income taxpayers cannot claim the credit.

- A credit of up to $4,000 may be available for buying a used EV subject to more modest income eligibility limits.

- The IRS expands and extends a 30% credit for installing solar panels or other renewable energy equipment. Costs incurred from the beginning of 2022 may qualify before the credit begins to phase out in 2033.

- A 30% residential energy credit is generally available up to a maximum of $1,200 ($2,000 in some cases), with annual caps on certain items, for 2023 through 2032.

We will have more details on the "new and improved" energy credits in future issues.

Excess business losses: Under the TCJA, owners of pass-through entities—including S corporation owners, partners in a partnership and some limited liability company (LLC) owners, as well as sole proprietors—cannot claim excess business losses against non-business income. The thresholds are $250,000 for single filers and $500,000 for joint filers. (The indexed thresholds for 2022 are $270,000 and $540,000, respectively.) This provision was scheduled to expire after 2025 but was extended through 2026 by subsequent legislation. Now the IRA extends it again through 2028.

Research credits: Currently, a qualified start-up business can elect to use up to $250,000 of qualified research credits to offset payroll taxes instead of income taxes. This tax break may be available to businesses with annual gross receipts of $5 million or less. The new law increases the $250,000 cap to $500,000 after 2021.

IRS administration and enforcement: The IRA sets aside an additional $3.18 billion for the IRS to provide taxpayer and other services. In an attempt to close an estimated $441 billion tax gap and provide more resources for the agency, which has been underfunded for years, the new law also appropriates $45.6 billion more for various tax collection and investigation services. Note: The new law establishes that the likelihood of families with taxable income below $400,000 being targeted for audits will not increase.

Significantly, the final version of the new law did not crack down on the "carried interest" loophole, as was initially proposed. This tax break enables certain investment managers to benefit from favorable capital gain rates after a three-year holding period. Nor did the IRA eliminate the $10,000 annual cap on state and local tax (SALT) payments imposed by the TCJA, for which some members of Congress had advocated.

Reminder: This is only an overview. Contact your professional tax advisors concerning your situation.

Do Not Take the Phishing Bait
How to identify and avoid scams

Have you been targeted by a phishing scam? You are certainly not alone. According to the Federal Trade Commission (FTC), thousands of new phishing scams are launched each and every day. The scammers do not take weekends off, either.

We have warned you about phishing in the past, but it does not hurt to revisit this issue, given what is at stake.

What exactly is phishing? It is a crime designed to steal your information through an email, text, or pop-up on your computer. Typically, the communication appears to originate from an organization or person you know, such as a friend in your email address book. The contact asks you to update, validate or confirm certain information.

Then you are directed to a website that looks legitimate. This fake site is used to fool you into revealing sensitive data that con artists can use for illegal purposes. They may even pretend to be the IRS!

What can you do? The first thing is to learn how to spot a phishing scam. Consider these five warning signs.

1. Urgent requests or threats: If you are told to immediately open an email attachment, click on a link, or call a number, be suspicious. Creating a false sense of urgency is one of the tricks in a scammer's bag. Similarly, if you are threatened with an immediate penalty or cancellation of a service if you do not respond promptly, tread carefully.

2. New or infrequent sources: Just because you receive an email from an unknown person does not mean it is a phishing scam. But it might be. If you do not recognize the address, proceed with caution. In the same vein, do not automatically open messages from someone you have not heard from in years if it states something like, "Hey, did you see this?"

3. Misspellings and incorrect grammar. Most legitimate organizations have the resources to ensure that communications contain proper spelling and grammar. If an email has an obvious mistake—or even worse, several—it could be a tip-off you are being scammed.

4. Mismatched domains: Be wary if you receive an email from a company, you are familiar with, but the message is originating from another email domain like gmail.com. Also, look out for misspellings of email domains. It is unusual for a reputable company not to get it right.

5. Links and attachments: Be careful clicking on links or opening attachments that you suspect could be phishing. Take the time to verify that the message is coming from whom it is purported to be.

This article has already provided some of the actions to take if you have identified a phishing scam, but here is a brief summary of what to do.

- Do not click on any links or attachments in suspicious emails.
- To verify legitimacy, visit the firm's website through a new tab on your browser or call the phone number listed on a membership card, statement, or official website.
- If the suspicious message supposedly was sent by someone you know, contact that person via some other means (e.g., text or phone call) to confirm it.
- Delete the message.

Finally, report phishing scams to the FTC on its website at https://reportfraud.ftc.gov/#/ or call 1-877-382-4357.

Seeking Out Section 530 Relief
Safe-harbor rule to the rescue

The IRS often contests an employer's classification of workers as independent contractors as opposed to employees. If a worker is labeled as an independent contractor, the employer does not have to pay its fair share of federal payroll taxes, nor does it have to provide costly fringe benefits available to employees. This can result in significant savings.

Fortunately, your business may be able to fall back on a fail-safe rule called "Section 530 relief." This refers to a provision in a 1978 law, not a section of the Internal Revenue Code.

Key information: For 2022, the Social Security portion of payroll tax is 6.2% of the first $147,000 of an employee's wages, while the 1.45% tax for the Medicare portion applies to all their wages. When you multiply these amounts for a group of workers, you can easily see what is at stake.

Volumes have been written about the distinctions between independent contractors and employees, but it essentially boils down to the degree of control the employer exerts over the worker. If you dictate how the worker performs the job, they are generally treated as an employee. On the other hand, if the worker is basically operating on their own, they may qualify as an independent contractor.

Section 530 relief may come into play when a business is assessed back taxes and penalties for misclassifying workers as independent contractors. Briefly stated, if the employer can show it had a reasonable basis for treating workers as independent contractors, the additional taxes and penalties may be waived.

Specifically, to qualify for Section 530 relief, your business must meet the following three requirements.

1. Reasonable basis: You must have a reasonable basis for not treating workers as independent contractors. This might be established by one of the following:

- A related court case or IRS ruling.
- A prior IRS audit involving examination of payroll taxes at a time when you treated similar workers as independent contractors and there was no IRS reclassification of these workers.
- A significant segment of your industry treats similar workers as independent contractors.
- You are relying on some other reasonable authority (e.g., the opinion of an attorney or CPA familiar with the business operation).

2. Employment status consistency: In the past, the employer has always, without exception, treated the workers and any similar workers as independent contractors.

3. Reporting consistency: The employer has consistently treated the workers as independent contractors on federal tax returns. For instance, your business must have provided workers with Form 1099s. If you had W-2s prepared for only some of the workers in the group, your claim will be denied.

Be aware that you must meet **all three requirements**. If you slip up on just one, Section 530 relief is not available.

Finally, if you are not sure you are correctly treating workers as independent contractors, you can ask the IRS for a determination on Form SS-88. Have your professional tax advisor guide the way.

Sit Right Down and Write a Letter
Instructions for your estate plan

If you are concerned about your family's future, you should have a valid will executed. However, a will does not do much good if it cannot be found or if the terms are not clear. To avoid potential family squabbles, you may want to draft a **letter of instructions** to accompany the will.

This is an informal letter giving your heirs information concerning estate matters. It does not carry the same legal weight as a will, but it is important nonetheless. For instance, the letter may specify requests that should be carried out upon death. Copies of the letter should be attached to the original will and your personal copy. In addition, place another copy in an accessible location known to family members, so it will be easy to find the letter in times of emotional distress.

A letter of instructions may cover a variety of issues, but here are several areas likely to be included:

- **Explanation of assets**: The letter may provide a detailed inventory of assets, especially those likely to be overlooked when the estate is settled. This can include checking and savings accounts (with records of passbooks and their locations); safe deposit boxes and their contents; business insurance and accident insurance policies; retirement plans; Social Security and VA benefits; stocks, bonds and other investments (including the names of brokers and account numbers); information on real estate holdings, mortgage insurance and life insurance policies. Include the insurance company's name, your policy number, the name of the agent handling the policy and any relevant papers.

- **Location of documents:** Besides those assets already accounted for, you should also list all of your important personal and financial papers. This may prove helpful in settling your affairs. For example, you should disclose the whereabouts of your past federal and state tax returns and the records required for this year's returns. Do not forget to list all debts, credit cards and other accounts that may need to be paid off, cancelled or transferred to your spouse's name.

- **Miscellaneous instructions:** Other items of a personal nature may be included in a letter of instructions. Some of the possibilities are funeral, burial or cremation arrangements or wishes; fees that have been paid and cemetery plots selected; names, addresses, email addresses and telephone numbers of people and organizations to be notified upon death; contact information for your CPA and financial advisors; and other specific instructions for handling personal affairs.

- **Other information:** You may want to state personal preferences and desires in the letter (e.g., your wishes concerning the education of your children). Finally, you may explain the amounts that the heirs can expect to receive as inheritances and the reasons for the distributions.

Remember that a letter of instructions is not a legally binding document. It should **not** be used as a replacement for a will, but it can still provide valuable direction. Coordinate with this with other aspects of your estate plan.

A Roth for Your Child? That Works

If your child in high school or college earned money from a summer job, they may want to splurge on a new cellphone or other electronic device. But you may propose a practical alternative for at least some of the cash: Contributing to a Roth IRA.

There is no age restriction on young Roth contributors as long as the child has “earned income” like wages. Contributions for 2022 are limited to $6,000.

Although tax-free distributions from a Roth IRA generally are not available until the child turns age 59½, these contributions may grow into a sizeable nest egg. Also, penalty-free early withdrawals may be allowed due to disability or for a first-time home purchase (up to $10,000). Finally, your child will learn a valuable lesson about retirement saving!

Facts and Figures
Timely points of particular interest

Bargaining CHIPS—The Creating Helpful Incentives to Produce Semiconductors and Science Act—or just the “CHIPS Act,” for short—was signed into law on August 9. This new legislation, passed with bipartisan support, provides approximately $52 billion in funding for manufacturers to produce computer chips. It also creates a new 25% tax credit over a five-year period for investments in chip manufacturing, beginning with qualified property placed in service after 2022.

Looming Deadline—The IRS is advising taxpayers who requested an automatic six-month filing extension for a 2021 return to “beat the rush.” The filing deadline is **October 17, 2022**, but you do not have to wait until next month to get your house in order. You can avoid last-minute scrambling by assembling all the documentation that will be needed to have your return filed in time. Reminder: The extension is only for filing your return, not for paying tax that is due, so find out about any tax liability.

Student Loan Forgiveness—On August 24, 2022, President Biden announced sweeping changes for borrowers with student loan debt. Notably, up to $10,000 of debt will be forgiven on most federal student loans and up to $20,000 on Pell Grants. To qualify, individuals must have earnings of less than $125,000 or $250,000 for married couples. The loan forgiveness will be exempt from tax. Also, the president is extending the payment pause through 2022. We will have more details in a future issue.