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Credits and Incentives to Incorporate in Year End Planning

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Credits and Incentives to Incorporate in Year End Planning

November 16, 2021

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Agenda

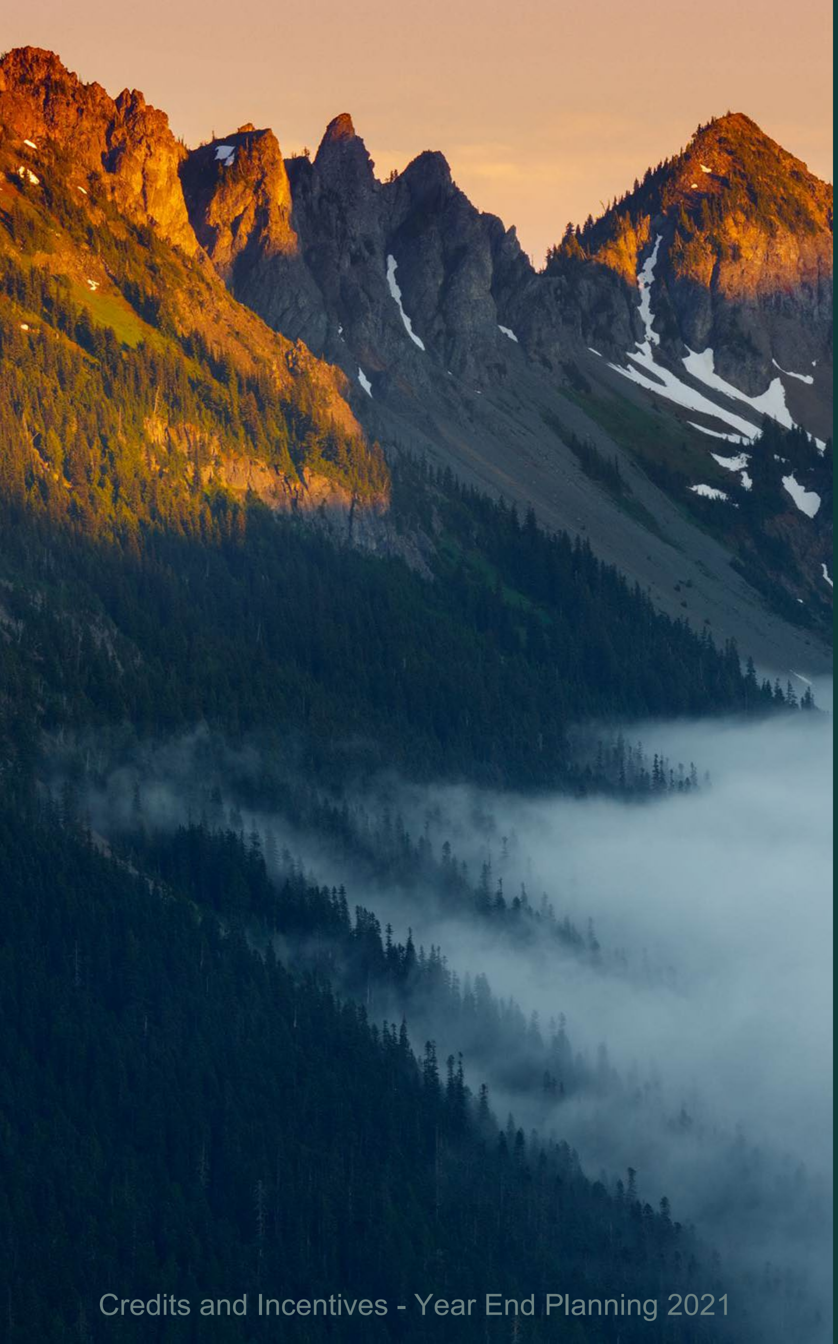
01 **BIDEN ADMINISTRATION'S TAX CREDIT UPDATE**
Craig Lammlin

02 **MODIFIED INCENTIVES & ERTC**
Gabriel Sermeno

03 **CAPITALIZE R&D TAX CREDITS**
Liddy Steele

04 **INTERNATIONAL TAX INCENTIVES**
Wakako Byer

05 **Q&A**
All



Learning Objectives

- Describe different tax credits companies can leverage to improve cashflow
- Explain the current state of President Biden’s tax agenda
- Compare the benefits of the FDII and IC-DICS incentives

The Biden Administration’s Tax Credit Agenda and Credit Update

Current Legislative State of the Biden Administration's Tax Credit Agenda

Legislation of the Biden Agenda

$1.2T Bipartisan Infrastructure Framework

- “Hard” Infrastructure Bill

$1.75T Build Back Better Act

- Social Spending and Climate Bill

$550 billion to **fight climate change**, largely through tax incentives for low-emission sources of energy

Proposed Tax Incentives In The Biden Administration's Tax Agenda

Credit Base Rate versus Bonus Rate

Creates enhanced credit rate provision for various new and existing renewable energy and energy efficiency incentives, providing either a *base rate* or a *bonus rate*.

The *bonus rate* is equal to 5x the *base rate*. To receive the bonus rate:

- A taxpayer needs to pay the prevailing wage to any laborers or mechanics employed by contractors and subcontractors during the construction of the project; and
- Ensure that no fewer than the applicable percentage of total labor hours of the project are performed by qualified apprentices:
- 10% for projects for which construction begins in 2022,
- 12.5% in 2023, and
- 15% thereafter

There are significant penalties in the event a taxpayer fails to satisfy the prevailing wage and apprenticeship requirements.

Domestic Content Credit Enhancement

DOMESTIC CONTENT

To meet the Domestic Content requirement, a taxpayer must ensure any steel, iron, or manufactured product which is part of the project at the time of completion was produced in the United States.

Steel and iron that are not part of a manufactured product must be 100% produced in the United States.

Manufactured products are deemed to have been manufactured in the United States if not less than the adjusted percentage of the total cost of the components and subcomponents is attributable to components which are mined, produced, or manufactured in the United States.

- The adjusted percentage is:
  - 40% for projects that begin construction before 2025,
  - 45% for projects that begin construction in 2025,
  - 50% for projects that begin construction in 2026, and
  - 55% percent for projects that begin construction thereafter.

Offshore wind facilities have reduced adjusted percentage requirements.

Elective Payment Option

SECTION 136104. ELECTIVE PAYMENT FOR ENERGY PROPERTY AND ELECTRICITY PRODUCED FROM CERTAIN RENEWABLE RESOURCES

The provision allows taxpayers to elect to be treated as having made a payment of tax equal to the value of the credit they would otherwise be eligible for several green incentives listed below.

Section 48 ITC	Section 45X clean hydrogen production credit
Section 45 PTC	Section 48E advanced manufacturing investment credit
Section 45Q credit for carbon capture and sequestration	Section 45AA advanced manufacturing production credit
Section 30C alternative fuel vehicle refueling property credit	Section 45BB clean electricity production credit,
Section 48C advanced energy project credit	Section 48F clean electricity investment credit
Section 48D investment credit for transmission property	Section 45CC clean fuel production credit
Section 45W zero-emission nuclear power production credit	

New Federal Incentives

Proposed Federal Tax Incentives Changes

SECTION 45X CREDIT FOR PRODUCTION OF CLEAN HYDROGEN

- Creates a new tax credit to make clean hydrogen produced by a taxpayer at a qualified clean hydrogen facility beginning in 2022 during the ten-year period beginning on the date such facility is placed in service.
- Taxpayers may claim the section 45 PTC for electricity produced from renewable resources by the taxpayer if such electricity is used at a qualified clean hydrogen facility to produce qualified clean hydrogen.
- A taxpayer may elect to treat a qualified clean hydrogen facility as energy property for purposes of the section 48 ITC in lieu of the credit to produce clean hydrogen.
- If the taxpayer elects to claim the section 48 ITC in lieu of the hydrogen production credit, the provision provides a base credit rate of 6%, or a bonus credit rate of 30%, of the basis of qualified energy property.
- Taxpayers would be able to elect to receive a cash payment in lieu of a tax credit through a direct pay mechanism.

Proposed Federal Tax Incentives Changes

SECTION 45Y CREDIT FOR QUALIFIED COMMERCIAL ELECTRIC VEHICLES

- Creates a new credit for qualified commercial electric vehicles placed into service by the taxpayer.
- The amount of credit is 30% of the cost of such vehicle.
- A leasing company may elect to determine the credit using the structure of the individual credit under section 36C if the vehicle is leased to an individual.
- Tax-exempt entities have the option of electing to receive direct payments.
- No credit shall be allowed under this provision for a vehicle acquired after December 31, 2031.

New Federal Incentives

SECTION 45Z LABOR COSTS OF INSTALLING MECHANICAL INSULATION PROPERTY

- A credit of the labor costs incurred for installing mechanical insulation property into a mechanical system which was originally placed in service not less than one year before the date on which such mechanical insulation property is installed.

- The base credit rate is 2%, which is increased to 10% for projects meeting prevailing wage and apprenticeship standards.

- The credit is available for costs paid starting in 2022 through the end of 2031.

Proposed Federal Tax Incentives Changes

SECTION 48D NEW ELECTRIC TRANSMISSION PROPERTY INVESTMENT TAX CREDIT

Provides for a tax credit for the basis of qualifying electric transmission property placed in service by the taxpayer.

Provides for a base credit rate of 6% of the basis of qualified electric transmission property or a bonus credit rate of 30% of the basis of qualified electric transmission property.

Qualifying electric transmission property is defined as tangible, depreciable property which is:

- An electric transmission line which is capable of transmitting electricity at a voltage of not less than 275 kilowatts and has a transmission capacity of not less than 500 megawatts; or
- Related transmission property

This credit is effective for property placed in service after December 31, 2021, and before January 1, 2032.

Taxpayers would be able to elect to receive a cash payment in lieu of a tax credit through a direct pay mechanism.

Proposed Federal Tax Incentives Changes

SEC 48E ADVANCED MANUFACTURING INVESTMENT CREDIT

- Creates an investment tax credit (ITC) worth up to 25% for advanced manufacturing facilities, and an advanced manufacturing production tax credit for eligible components.
- All taxpayers are eligible for an ITC of at least 5%.
- Taxpayers paying prevailing wages and utilizing registered apprenticeship programs are eligible for a bonus ITC of 25%.
- The investment tax credit is available for property for the manufacturing of semiconductors and semiconductor tooling equipment, including buildings and equipment that are integral to such manufacturing, that commences construction before January 1, 2027.
- Taxpayers would be able to elect to receive a cash payment in lieu of a tax credit through a direct pay mechanism.

Proposed Federal Tax Incentives Changes

SECTION 40B SUSTAINABLE AVIATION FUEL CREDIT

- Beginning in 2023, provides a refundable blenders tax credit for each gallon of sustainable aviation fuel sold as part of a qualified fuel mixture.
- The credit is determined on a sliding scale, equal to $1.25 plus an additional $.01 for each percentage point by which the lifecycle emissions reduction of such fuel exceeds 50%.
- Taxpayers may elect to claim this credit as an excise tax credit against section 4041 excise tax liability.

Modified Federal Incentives

Proposed Federal Tax Incentives Changes

SECTION 45 PRODUCTION TAX CREDIT: EXTENSION AND MODIFICATION

- Extends the PTC, allows energy producers to claim a credit based on electricity produced from renewables through December 31, 2026.
- Base credit rate of 0.5 cents/kilowatt hour, or a bonus credit rate of 2.5 cents/kilowatt hour.
- Taxpayers may claim an increased credit for facilities placed into service after December 31, 2021, if such facilities meet domestic content requirements.
- Taxpayers would be able to elect to receive a cash payment in lieu of a tax credit through a direct pay mechanism.

Proposed Federal Tax Incentives Changes

SECTION 48 ENERGY INVESTMENT TAX CREDIT: EXTENSION AND MODIFICATION

- Extends the ITC, for the cost of energy property for property which constructions through December 31, 2026.
- A base credit rate of 6% of the basis of energy property or a bonus credit rate of 30% of the basis of energy property for facilities placed into service after December 31, 2021.
- Taxpayers may claim an increased credit with respect to energy property placed into service after December 31, 2021, if it meets the domestic content requirements.
- Newly eligible property includes energy storage technology, linear generators, microgrid controllers, dynamic glass, or biogas property.
- Taxpayers would be able to elect to receive a cash payment in lieu of a tax credit through a direct pay mechanism.

Proposed Federal Tax Incentives Changes

SECTION 45Q CARBON CAPTURE AND SEQUESTRATION: EXTENSION AND MODIFICATION

- Extends the credit for carbon oxide sequestration facilities that begin construction before December 31, 2031.
- A base credit rate of $17 or a bonus credit rate of $85 per metric ton of carbon oxide captured for geological storage.
- A base credit rate of $12 or a bonus credit rate of $60 per metric ton of carbon oxide captured and utilized for an allowable use by the taxpayer.
- Taxpayers would be able to elect to receive a cash payment in lieu of a tax credit through a direct pay mechanism.

Proposed Federal Tax Incentives Changes

SECTION 40A ALTERNATIVE BIODIESEL, RENEWABLE DIESEL, AND ALTERNATIVE FUELS: EXTENSION

- Extends the income and excise tax credits for biodiesel and biodiesel mixtures at $1.00 per gallon through December 31, 2026.
- Extends the $0.50 per gallon excise tax credits for alternative fuels and alternative fuel mixtures through December 31, 2026.
- Extends the $0.10-per-gallon small agribiodiesel producer credit through December 31, 2031.

SECTION 40 SECOND GENERATION BIOFUEL INCENTIVE: EXTENSION

- Extends the second-generation biofuel income tax credit through December 31, 2026.

Proposed Federal Tax Incentives Changes

SECTION 48C ADVANCED ENERGY PROJECT CREDIT: EXTENSION

Revives the Section 48C qualified advanced energy property credit

- $5B in credits a year for 2022 through 2023
- $1.875B a year for 2024 through 2031

Reserved for projects in automotive communities:

- $800M for 2022 through 2023
- $300M a year for 2024 through 2031

Reserved for projects located in energy communities

- $800M for 2022 through 2023
- $300 million a year for 2024 through 2031
- Projects receive a base credit rate of 6% of qualified investments in qualified advanced energy projects or a bonus rate of 30% if eligible
- Taxpayers would be able to elect to receive a cash payment in lieu of a tax credit through a direct pay mechanism

Proposed Federal Tax Incentives Changes

SEC 45AA ADVANCED MANUFACTURING PRODUCTION CREDIT

- Provides a production credit for each eligible component which is produced and sold.
- Eligible components include solar polysilicon, wafers, cells, and modules, and wind blades, nacelles, towers, and offshore foundations.
- The credits are generally provided on a mass or watt-capacity basis.
- The amount credit allowed for eligible components is increased by 10% if the final assembly of the such components is at a facility in the United States which operates under a union-negotiated collective bargaining agreement.
- The credits are provided for eligible components produced and sold before January 1, 2027.
- Taxpayers would be able to elect to receive a cash payment in lieu of a tax credit through a direct pay mechanism.

Proposed Federal Tax Incentives Changes

SECTION 45BB AND SECTION 48F CLEAN ELECTRICITY PRODUCTION AND CLEAN ELECTRICITY INVESTMENT CREDITS

- Creates an emissions-based incentive that would be neutral and flexible between clean electricity technologies.
- Taxpayers can choose between a PTC or an ITC, which is provided based on the carbon emissions of the electricity generated—measured as grams of carbon dioxide equivalents (CO2e) emitted per KWh generated.
- Any power facility of any technology can qualify for the credits, so long as the facility's carbon emissions are at or below zero.

Employee Retention Tax Credit (ERTC) Update

ERTC

Tax relief for certain employers impacted by COVID-19

Originally enacted as part of the **CORONAVIRUS AID, RELIEF, AND ECONOMIC SECURITY, (CARES) ACT** beginning March 13, 2020, eligible employers are entitled to a refundable tax credit used to offset their employment taxes.

CONSOLIDATED APPROPRIATIONS ACT (CAA), 2021, further extended the ERTC through June 30, 2021, and included certain enhancements that apply starting January 1, 2021.

THE AMERICAN RESCUE PLAN ACT (ARPA) signed by President Biden extended the ERTC enhancements under the CAA through the end of 2021.

Who’s Eligible

2020 QUALIFICATION GUIDELINES MARCH 13–DECEMBER 31	2021 QUALIFICATION GUIDELINES JANUARY 1–DECEMBER 31
Who’s Eligible	
1. Employers whose business was fully or partially suspended due to emergency orders from an appropriate government authority that limited commerce, travel, or group meetings • The portion of the suspended operations needs to be a “more than nominal” portion of the whole business’ operations, for example, the gross receipts OR employee hours made up at least 10% of the entire business operations in the same 2019 quarter ***OR*** 2. Employers who had at least a **50%** reduction in gross receipts for the current calendar quarter as compared to the same calendar quarter in 2019 • In determining the gross receipts reduction, employers must confirm if the aggregation rules apply based on ownership structure	1. Employers whose business was fully or partially suspended due to emergency orders from an appropriate government authority that limited commerce, travel, or group meetings • The portion of the suspended operations needs to be a “more than nominal” portion of the whole business’ operations, for example, the gross receipts OR employee hours made up at least 10% of the entire business operations in the same 2019 quarter ***OR*** 2. Employers who had at least a **20%** reduction in gross receipts for the current calendar quarter as compared to the same calendar quarter in 2019 • In determining the gross receipts reduction, employers must confirm if the aggregation rules apply based on ownership structure

Employee Threshold

2020 QUALIFICATION GUIDELINES MARCH 13–DECEMBER 31	2021 QUALIFICATION GUIDELINES JANUARY 1–DECEMBER 31
Employee Threshold for Determining Qualified Wages	
• For employers with **100 or fewer** full-time employees, measured as average employment in 2019, the credit applies to wages paid to all employees. • For employers with more than **100** full-time employees, the credit only applies to wages paid to employees during the time they weren't providing services. • In determining the number of employees, employers must confirm if the aggregation rules apply based on ownership structure.	• For employers with **500 or fewer** full-time employees, measured as average employment in 2019, the credit applies to wages paid to all employees. • For employers with more than **500** full-time employees, the credit only applies to wages paid to employees during the time they weren't providing services. • In determining the number of employees, employers must confirm if the aggregation rules apply based on ownership structure.

Credit Calculations

2020 QUALIFICATION GUIDELINES MARCH 13–DECEMBER 31	2021 QUALIFICATION GUIDELINES JANUARY 1–DECEMBER 31
Calculating the Credit	
• The credit is equal to **50%** of wages paid to an employee after March 12, 2020, in each qualifying calendar quarter, up to a total of **$10,000** for **all quarters**, per employee. • The credit may be worth up to **$5,000** per eligible employee. • Qualified wages, for purposes of this program, include qualified health plan expenses incurred by the employer.	• The credit is equal to **70%** of wages paid to an employee after December 31, 2020, in each qualifying calendar quarter, up to a total of **$10,000 per quarter**, per employee. • The credit may be worth up to **$28,000** per eligible employee. • Qualified wages, for purposes of this program, include qualified health plan expenses incurred by the employer.

Other Considerations

- Currently set to expire at the end of Calendar 2021
  - Bipartisan Infrastructure Bill changes expiration date to 9/30/21
  - Credit can be claimed within three years from the date you filed your original return or within two years from the date you paid any tax due
- Expect to see audits of this credit
- Refund timing: IRS catching up, still at least 16-18 weeks
- How to find out where your refund is: 1-800-829-1040

Client Profile

- Broadly based credit
- Typical client profile
  - For profit or tax-exempt businesses
  - Construction
  - Health care
  - Restaurants
  - Retail
  - Small employers < 100 FTE in 2020; <500 in 2021

R&D Expense Capitalization

The Change

- Before 1/1/2022
  - Eligible R&D expenses are immediately deductible under IRC § 174
- After 1/1/2022
  - R&D expenses are amortized over 5 years, and 15 years if expenses are incurred outside the United States

General Impact

Impact if the switch is made:

- Increased expenses carried over into the following year
- Increased net income in the current year
- Increased tax in the current year

Example: A company has $10M in revenue and spends $100M offshore on drug development. Traditionally, the company would have a $90M taxable loss. When the standing law goes into effect in 2022, however, the company could have $6.7M of taxable profit instead.

This impact could eventually level-out after 5 years (or 15 years) if a taxpayer incurs a consistent amount of R&D expenses each year

Significant Impact

Which taxpayers will be impacted the most:

- Taxpayers with significant annual R&D expenses in proportion to income: pharmaceutical, bio-tech, start-ups
- Taxpayers with significant annual R&D expenses incurred outside the United States which will be amortized over 15 years

Current Status

Bipartisan support to include language delaying or eliminating the switch to capitalization of R&D expenses through budget reconciliation.

- 90 cosponsors in the House, and 22 cosponsors in the Senate support completely eliminating the provision
- Currently negotiating at least a 4-year delay
- Back-up plan is at least a 1-year delay, likely to be renewed each year like the renewal process for the R&D credit before it was made permanent in 2016

GIVEN THE UNCERTAINTY AROUND IF, AND WHEN, THE RULE CHANGE WILL GO INTO EFFECT, WHAT CAN TAXPAYERS DO TO MITIGATE THE IMPACT?

Planning Methods

Tax planning methods to mitigate the impact:

1. Cash flow planning
2. Documentation of R&D tax credits
3. Accounting method links
4. Technical accounting
5. Financial Accounting Standards Board (FASB) ASC Topic 740

International Tax Incentives (FDII, IC-DISC)

International Tax Incentives

Foreign Derived Intangible Income (FDII) Deduction

- Introduced as part of the Tax Cuts and Jobs Act (TCJA), effective tax years beginning after December 31, 2017.
- Available only to C corporations.
- Currently 37.5% deduction of the excess of the corporation's income from export sales over a fixed return on its tangible depreciable assets for the year, and 21.87% deduction starting 2025.

Current Proposals related to FDII (as of October 2021)

President Biden **Made in America Tax Plan**	**Sen. Wyden** **International Taxation Overhaul**	**Rep. Neal** **Build Back Better Act**
Repeal FDII but provide a new general business credit equal to 10% of the eligible expenses paid or incurred in connection with onshoring a US trade or business, as well as disallow deductions for expenses paid or incurred in connection with offshoring a US trade or business.	Changing FDII to reward *deemed innovation income* through a deduction based on a certain percentage of specific domestic activity qualifying as R&E or qualified work training	FDII would be taxed at 15.8% by changing the Section 250 deduction to 24.8% from the current 37.5%, if corporate rate remains at 21%.
Effective date: generally, after December 31, 2021	Effective date was not included	Effective date: generally, tax years beginning after December 31, 2022

Interest Charge Domestic International Sales Corporation (IC-DISC)

IC-DISC

- IC-DISC intended to provide incentives for US companies to manufacture in the US and export those goods
- US Domestic Corporation: election to be treated as an IC-DISC
- Available to almost any taxpayer, including individuals, C corporations, S corporations, partnerships, or LLCs

Interest Charge Domestic International Sales Corporation (IC-DISC)

CURRENT OPERATIONS AND CALCULATIONS

- Quantify qualifying export sales from qualified export property
  - Manufactured, produced, or grown in United States
  - No more than 50% foreign content
  - For consumption outside the United States
- Allocate and apportion expenses to export sales
- Compare which yields the larger commission: 4% of revenue or 50% of taxable income

Interest Charge Domestic International Sales Corporation (IC-DISC)

CURRENT OPERATIONS AND CALCULATIONS

- Larger of two amounts becomes IC-DISC commission
  - Supplier gets a deduction at ordinary rates
  - IC-DISC recognizes income and does not pay federal tax
- IC-DISC then pays dividend of its earnings to shareholder who pays tax at lower Sec. 1(h)(11) tax rate

Interest Charge Domestic International Sales Corporation (IC-DISC)

BENEFIT

- Approximately 13.2% current tax benefit based on top tax rate for ordinary income of 37% and qualified dividends for individuals, including the net investment income tax, of 23.8%.
- Additional considerations at the state tax level.
- Potential opportunities to defer taxable income into future periods through accounts receivable (A/R) factoring and create additional operating cash flow and time value of money savings.

Interest Charge Domestic International Sales Corporation (IC-DISC)

A/R FACTORING

- A company sells its accounts receivable to another person in exchange for payment now
- The buyer pays a discount to consider factors such as:
  - Recourse or non-recourse
  - Credit worthiness of debtors
  - Administration required to collect the funds
- Under US tax principles, the spread earned between the price paid and the amount collected is considered interest when the factoring occurs between related parties

Interest Charge Domestic International Sales Corporation (IC-DISC)

A/R FACTORING

- A company sells its accounts receivable to another person in exchange for payment now. The buyer pays a discount to consider factors such as:
  - Recourse or non-recourse
  - Credit worthiness of debtors
  - Administration required to collect the funds
- The A/R resulting from an export sale is a qualified export asset
- The spread between the amount collected and the amount paid for the A/R is qualified export revenue as it is interest arising from a qualified export asset

Interest Charge Domestic International Sales Corporation (IC-DISC)

KEY TAKEAWAYS

- FDII provides benefits for C corporations that have export sales, where requirements are not as stringent to qualify compared to an IC-DISC. C corporation taxpayers can potentially use both FDII and IC-DISC planning, although adjustments to calculation are required as commission reduces foreign derived deduction eligible income and FDII deduction reduces commission calculation.
- Non-C corporation taxpayers can consider an IC-DISC for export sales, and further create benefits through commission calculation on transaction by transaction, A/R factoring, and deferral.

Questions?

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