MANAGEMENT & *TAX CONCEPTS*

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EXPANDED ENERGY TAX INCENTIVES BENEFIT BUSINESSES

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Expanded energy tax incentives benefit businesses

The Inflation Reduction Act (IRA), signed into law in August 2022, contains a number of provisions designed to reduce carbon emissions and spur development of clean energy. Many of these provisions target producers of clean energy, but the act also significantly expands energy-related tax incentives for businesses in general as well as for individuals. Let's take a closer look at the expansion of two valuable tax breaks for eligible real estate developers, builders and owners: the tax credit for new energy-efficient homes and the deduction for energy-efficient commercial buildings.

CREDIT FOR NEW ENERGY-EFFICIENT HOMES

The tax credit for new energy-efficient homes — also known as the Section 45L credit — had expired at the end of 2021, but the IRA extended it retroactively to the beginning of 2022 and forward through 2032. For 2022, as before, this provision offers eligible home-builders or developers (both single and multifamily) a credit of up to $2,000 for each new dwelling unit that meets specific energy-efficiency standards.

Starting in 2023, however, a multitier tax credit takes effect. Under the new rules, an increased credit of $2,500 is available for single-family and manufactured homes that meet standards set by the ENERGY STAR Residential New Construction Program or Manufactured Homes Program. The credit is doubled, to $5,000, for single-family and manufactured homes that are certified as "zero energy ready homes" (ZERH) by the U.S. Department of Energy.

For multifamily homes built in 2023 or later, the new rules provide a $500 per unit credit for homes that meet ENERGY STAR Single Family New Homes Program standards or $1,000 per unit for homes that meet ZERH standards. These credits are increased to $2,500 and $5,000, respectively, if the project meets prevailing wage requirements.

What does that mean? Generally, any laborers and mechanics employed by the taxpayer or any contractor or subcontractor in the construction of the home must be paid wages at rates not less than the prevailing rates for construction, alteration or repair of a similar character in the locality where the home is located, as most recently determined by the Secretary of Labor.

Updated electric vehicles tax credit creates challenges for consumers

The Inflation Reduction Act (IRA) extended the existing $7,500 tax credit for eligible purchases of new electric vehicles (EVs) and established a credit for used EVs equal to the lesser of $4,000 or 30% of the vehicle's cost. The IRA also eliminated the manufacturer sales cap, which phased out the credit once a manufacturer sold more than 200,000 EVs.

But the act made several important changes to the credit's eligibility requirements:

- For new (but not used) EVs, the credit is available only if
  - The EV was assembled in North America,
  - A certain percentage of battery minerals came from countries with which the United States has a free trade agreement, and
  - A specific percentage of battery components was manufactured or assembled in North America.
- Credits are unavailable to buyers with an adjusted gross income (AGI) over $150,000 ($300,000 for joint filers).
- Credits are limited to new EVs priced at $55,000 or less ($80,000 for SUVs, trucks and vans) and used EVs priced at $25,000 or less.

Initially, the sourcing requirements will make it difficult for most new EVs to qualify for the full credit, though a partial credit may be available. The requirements can be confusing, so it's important to familiarize yourself with the rules before you shop for a vehicle.

DEDUCTION FOR ENERGY-EFFICIENT COMMERCIAL BUILDINGS

Before the IRA was enacted, the Section 179D deduction allowed building owners to immediately deduct (rather than depreciate) up to $1.88 per square foot for the cost of energy-efficient improvements to new or existing commercial buildings and specific residential rental buildings. The deduction was also available to designers (such as architects, engineers, contractors or energy consultants) of some government-owned buildings.

Under pre-IRA rules, the maximum deduction was available for eligible improvements to a building's interior lighting system, HVAC/hot water systems or building envelope that were designed to reduce annual energy and power costs by at least 50% in comparison to applicable standards. Owners also could claim partial deductions of 63 cents per square foot for improvements to one of the above systems that met specific energy savings requirements.

The IRA significantly enhances the Sec. 179D deduction for property placed in service after December 31, 2022. Among other things, the act:

- Reduces the minimum required energy savings from 50% to 25%,
- Computes the base deduction on a sliding scale ranging from 50 cents per square foot for 25% energy savings to $1 per square foot for 50% or greater energy savings (partial deductions are eliminated),
- Increases the deduction, for owners that meet prevailing wage and apprenticeship requirements, on a sliding scale ranging from $2.50 per square foot for 25% energy savings to $5 per square foot for 50% or greater energy savings, and
- Allows a building's owner to claim the deduction as often as every three years (previously, the $1.88-per-square-foot deduction was a lifetime cap).

The act also expands eligibility to include real estate investment trusts (REITs) as well as designers of buildings owned by not-for-profit organizations, religious organizations, tribal organizations, and not-for-profit schools or universities.

REAP THE BENEFITS

If you build or develop energy-efficient homes, or if you're making energy-efficient improvements to a commercial building you own, get to know the tax incentives available to you. Work with your tax advisors to ensure that you receive the credits or deductions you deserve. •

4 steps to take before selling your business

The past couple years have shown that unexpected events can wreak havoc on even the best-laid business plan. In a volatile economic climate, it's wise to be prepared for every eventuality — including the possibility that you'll need to sell your business fast. Even if the sale isn't urgent, it's important to prepare your business for potential sale. That way, you'll have all the options at your disposal as you determine your business's future. Here are four helpful steps to take as you consider selling your business.

1. DETERMINE YOUR SALES TEAM

Your business is probably your most valuable asset, so it's important to begin the sale process with your eyes wide open. In most cases, the first step is to put together a team of experts who'll help you through the selling process.

A business broker will serve as the quarterback of your sales team. A broker can guide you in finding and qualifying prospective buyers, marketing your company to these prospects, setting a price for the business, and closing the sale. An attorney, an accountant and a valuation professional, each experienced in business sales and purchases, should round out your team.

Don't rush: You'll want to exercise caution in building your team. These individuals will play a critical role in the success of your business sale.

2. RESEARCH POTENTIAL BUYERS

Understanding the different types of business buyers is essential to formulating your sale strategy. Here are some of the main types:

- A *complementary* buyer is a company that sells products and services that complement or enhance those you sell.
- A *strategic* buyer is usually a competitor that's looking for companies where it can add value to their products and services.
- A *financial* buyer is generally one that's most interested in the potential return on investment.
- *Family and heirs* often present unique challenges, such as decisions involving who will (or won't) be able to buy ownership interests and who'll occupy positions of leadership.

Lastly, don't forget about your employees and managers. An internal sale could provide unique planning opportunities through the use of an Employee Stock Ownership Plan. And that will help ensure continuity for customers and staff.

3. DEFINE THE VALUE DRIVERS IMPORTANT TO BUYERS

Your specific goals for the sale of your business will hinge primarily on why you're selling. For example, if you mainly want to keep the business in your family and ensure a smooth transfer of ownership to your heirs, you need to identify the next generation of leaders and start grooming them years in advance of the sale. But if your goal is to sell the business to outsiders at the highest possible price, you should be taking steps long before the sale to boost the company's value to potential buyers.

In considering companies to purchase, most buyers will look at quantifiable measurements that will help them gauge their potential return on investment. Thus, the best way to increase your company's value to potential buyers — and boost its sale price — is to focus on the value drivers that will be important to them.

4. ENSURE YOUR BUSINESS IS APPEALING

Virtually all buyers will want to know about your business's financial health. They'll want to see a history of consistent cash flow, sales and earnings. You'll need to determine which key performance indicators are most important to your company's financial health and focus on improving them before you list your business for sale.

Human resources are usually the next area potential buyers examine. They'll want to see a strong executive team that can keep things running smoothly after you've left. And they'll want a skilled and stable workforce in place with relatively low employee turnover.

Your customer base also will enter the picture. Most buyers seek companies with a diversified base and low degree of customer concentrations. If your sales and earnings are heavily dependent on a handful of large customers, this could be a big red flag for buyers.

Last, but not least, business buyers usually want to acquire companies they can grow. Thus, you generally need to be able to show them a plan that demonstrates how they can grow the business after they buy it.

A STRONGER BUSINESS

Even if you decide to hold on to your business for the foreseeable future, taking steps to prepare for sale will give you a better sense of where the business stands. It also will help you evaluate which areas might need to be strengthened to improve its profitability going forward. •

When should you start your estate plan?

About 60% of Americans haven't prepared basic estate planning documents, according to a recent survey conducted by Caring.com. If you don't have an estate plan, the time to draft one is *now*. This is true regardless of how much property you own and whether you're single or married with children.

The consequences of delaying estate planning too long can be devastating to surviving family members. If you die without a last will and testament, for example, state law might end up deciding who receives your assets. And if you don't have a medical directive, your wishes with regard to end-of-life care decisions might not be followed.

WHAT IS IT?

Estate planning is the process of legally declaring how your assets will be distributed after you die and how financial and medical decisions will be made on your behalf if you can't make them yourself.

A typical estate plan includes the documents listed below. Keep in mind that you should be sure that someone knows that the documents exist, and where they can be found.

1. Last will and testament. This formally and legally declares who'll receive your property after you die. If you have minor children, it also assigns legal guardianship for them.

2. Living trust. Assets that are transferred via a will generally have to go through the probate process, which can be time-consuming and is public. A living trust facilitates the transfer of property while avoiding probate. It's revocable so you can control the assets while you're still alive. Even if you create a living trust, you'll still need a will to cover any assets that haven't been transferred to the trust (and to assign guardianship if you have minor children).

3. Durable financial power of attorney. This directive appoints a designated agent to manage your finances if you become incapacitated and can't manage them yourself. For example, your designated agent may pay bills and taxes, sign legal documents and serve on your behalf if any legal or financial situations arise while you're incapacitated.

4. Health care power of attorney. Also sometimes referred to as a health care proxy, this designates someone to make medical decisions on your behalf should you become unable to do so. Without a health care power of attorney, your family could have to go to court to have a guardian appointed.

5. Living will. Sometimes referred to as a medical directive, this explains how you want life-sustaining medical decisions to be made if you are incapacitated and can't communicate them yourself.

WHEN SHOULD YOU REVISIT YOUR PLAN?

Once you have an estate plan in place, it's important to review it periodically. You might need to update it in the following circumstances:

Marriage or divorce. Your estate planning documents should be changed to reflect your new spouse, or to remove your former spouse after a divorce. This includes listing or removing your spouse as your primary heir and decision-maker for end-of-life care decisions.

Birth of a child. Your will should be updated to specify who will raise your child if you die before he or she reaches the age of majority.

Acquisition of property or inheritance. You may want to update your will to specify who'll receive a large piece of property — like a home, yacht or recreational vehicle — or other significant asset after you die.

WHO ARE YOUR BENEFICIARIES?

Some types of property pass on to heirs automatically even if they aren't included in a last will and testament, such as life insurance death benefits and assets held in retirement accounts like 401(k)s — but only if you have named your beneficiaries. So, it's important to designate beneficiaries for these assets to make sure they go to the people you intend.

If no beneficiary is named, or if the named beneficiary is deceased, the court might end up deciding who receives assets like these. Therefore, you might also want to name contingent beneficiaries for these assets. In most cases, beneficiaries must have reached the age of majority and be mentally competent in order to receive the assets outright.

WHY PROCRASTINATE?

Don't let intimidation, procrastination or anything else keep you from creating an estate plan. Work with your attorney and tax advisor to draft an estate plan that's right for you and your family. •

Noncorporate taxpayers: Watch out for the excess business loss limitation

One of the advantages of operating a business as a sole proprietorship or pass-through entity (partnership, S corporation or limited liability company) is the ability of owners to deduct certain business losses on their individual tax returns. In other words, business losses can offset nonbusiness income, such as wages, interest, dividends or capital gains. However, the limit on excess business losses could reduce your deduction.

THE WAY IT WORKS

Historically, business loss deductions haven't been unrestricted: They can't exceed an owner's "at-risk basis" in the entity, for example. And the passive activity loss (PAL) rules prevent owners who don't actively participate in the business, or who are involved in specific rental real estate activities, from deducting losses against most nonpassive income.

Until recently, however, business owners who had sufficient at-risk basis and weren't subject to the PAL rules could use business losses to offset up to 100% of their taxable income. That changed with the passage of the Tax Cuts and Jobs Act (TCJA) in 2017.

Under the TCJA, for tax years 2018 through 2025 (extended through 2028 by legislation enacted in 2022), otherwise allowable business loss deductions are limited to $250,000 for single filers (including trusts and estates) and $500,000 for joint filers. (Note, however, that the CARES Act suspended this provision for tax years 2018, 2019 and 2020.)

The limits are adjusted annually for inflation. For 2022, they're $270,000 and $540,000, respectively, and for 2023, they're projected to reach $289,000 and $578,000, respectively. Losses in excess of these thresholds are treated as net operating losses (NOLs), which may be carried forward indefinitely and used to offset up to 80% of taxable income.

FOR EXAMPLE

Suppose that Laura, a single taxpayer, has $700,000 in investment income and other nonbusiness income in 2022. She also has a $600,000 loss from a business operated as a partnership in which she materially participates. She has sufficient at-risk basis in the partnership, and the PAL rules don't apply.

Before the excess business loss limitation took effect, Laura could have deducted the full amount of her $600,000 loss from her nonbusiness income. Now, however, her deduction is limited to only $270,000, while the excess business loss — $330,000 — must be treated as an NOL and carried forward to future years.

IMPACT ON TAXPAYERS

For noncorporate taxpayers with significant business losses, the excess business loss limitation may result in substantially smaller tax deductions. Affected taxpayers may face higher tax bills and should talk to their tax advisors about alternative tax-planning strategies for reducing or deferring taxable income.

Also, because the excess business loss limitation reduces one of the tax advantages of pass-through entities over corporations, new businesses should consider the limitation when weighing their choice-of-entity options. •

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TAX PLANNING AND PREPARATION

Taxes are a part of life, and at Martin Hood we can help you find ways to minimize the impact that taxes have on you and your family. We work with our clients year-round to develop and implement effective tax planning strategies to reduce year-end tax bills. Our state and international tax team performs extensive research in areas that reach beyond our local community. In addition to income tax preparation, we can prepare gift and estate tax returns, sales and payroll tax returns, and informational tax returns for not-for-profit organizations. We also assist clients with IRS audits and notices from tax authorities.

BUSINESS ADVISORY SERVICES

We provide accounting assistance and a comprehensive approach to helping with whatever keeps you up at night. We can help set up an accounting system to help you cover your accounting needs on your own in a more efficient manner, fill a temporary need for accounting staff, or fill a more permanent role in basic accounting or acting as an outsourced controller — all while keeping the bigger picture in mind and pulling in our tax, assurance, and planning expertise to serve as a well-rounded business advisor in nearly all tax, accounting, and financial matters.

ESTATE AND RETIREMENT PLANNING

The Estate and Retirement Planning team at Martin Hood helps our clients recognize the importance of proper planning for business succession, education, retirement, and wealth accumulation. This process is presented in an open and candid manner, placing family and retirement needs at the forefront of every plan. Our team strives to help you build a plan that minimizes the estate tax burden and helps you achieve your financial goals.

Tax Specialty Areas

- State and Local Taxation
- International Tax Issues
- Trusts and Estates
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- C corporations
- S corporations
- Individual tax compliance
- Tax planning
- Construction and Manufacturing
- Non-profits