

# TAX TALK

## 2022 YEAR-END TAX PLANNING FOR CANADIAN BUSINESSES AND INDIVIDUALS WITH OPERATIONS AND FILINGS IN THE U.S.

Tax planning is probably the last thing on most business owner's mind as they deal with supply chain issues due to COVID-19, high inflation and rapidly raising interest rate worries. These are not only business concerns, but also tax planning challenges. However, to take advantage of all available tax breaks, you need to be aware of tax changes in the recent U.S. Inflation Reduction Act and provisions of the Tax Cuts and Jobs Act (TCJA) that went into effect in 2018 but still impacts current tax planning.

This article highlights the key federal and state tax considerations for 2022 year-end tax planning for Canadian businesses with operations in the U.S.

### Summary

Year-end tax planning is more important this year as quick actions are required to claim generous bonus tax depreciation and full deduction for meals before the downward phase out and full phased out in 2023 for bonus depreciation and meals, respectively.

### Inflation Reduction Act ("IRA")

One of the most significant provisions of the IRA is the creation of a 15% corporate minimum tax rate. The minimum tax will be applicable to large U.S. corporations (with at least \$1 billion in "book income").

Another provision of the IRA is with respect to stock buybacks. Stock buybacks by corporations will face a 1% excise tax. Note that the excise tax is imposed only on U.S. public companies.

The corporate alternative minimum tax and excise tax on stock buybacks are effective for tax years beginning after December 31, 2022.

### Maximize Business Interest Expense Deduction

The TCJA is applicable for tax years beginning after December 31, 2017, imposes a limitation on business interest expense of many taxpayers, with exceptions for small businesses (those with three-year average annual gross receipts not exceeding \$27 million in 2022). For each tax year, businesses are required to compute their adjusted taxable income to determine their eligibility to deduct business interest expense paid during the year. The

deductible business expense was limited to 30% of the computed adjusted taxable income, and the computation for adjusted taxable income included an addback for tax depreciation and amortization. For tax years beginning with 2022, the addback for depreciation and amortization will no longer be included in the computation of adjusted taxable income. This change in the computation of adjusted taxable income may result in businesses having more interest disallowed for tax purposes. Disallowed interest is carried over indefinitely.

### Maximize Business Net Operating Loss Deductions

A net operating loss exists if a company's deductions exceed taxable income. Net operating losses ("NOL") are valuable deductions that can benefit a company by reducing taxable income in future years.

For tax years beginning in 2022, businesses that incur an NOL will only be allowed to carry the loss forward to be used in future years. While these losses can be carried forward indefinitely, they can only be used to offset 80% of taxable income of the business in the carry forward years.

### Research & Development

For tax years beginning with 2022, research and development costs must be capitalized and amortized. Research and Development (R & D) costs incurred in the U.S. will have an amortization period of five years, while those costs incurred outside the U.S. will have an amortization period of 15 years. This tax treatment is different from the way businesses accounted for these costs prior to 2022, where businesses could either deduct these costs or choose to capitalize and amortize them.

### Capital Asset Purchases and Tax Depreciation

Purchasing equipment and other qualified assets has been a valuable tool for reducing taxable income for businesses for years, but the TCJA that went into effect in 2018 further enhanced these opportunities by expanding bonus depreciation and expensing of qualified capital assets.

### Section 179 Expensing

If you are a small business, the Section 179 deduction is one of the most important tax codes you need to be familiar with in 2022. It lets you deduct all or part of the cost of equipment that is purchased or financed and put in place before the end of 2022.

For 2022, businesses can elect to expense (deduct immediately) the entire cost of new and used assets, such as equipment and furniture (see Qualified Property below) up to a maximum of U.S. \$1,080,000 for the first \$2,700,000 of property placed in service by December 31, 2022. Note that the Section 179 deduction cannot exceed net taxable business income and create a tax loss. The deduction is phased out dollar for dollar on amounts exceeding the \$2,700,000 threshold and eliminated above amounts exceeding \$3,780,000 for tax years beginning in 2022.

### Bonus Depreciation

Under bonus depreciation, businesses are allowed to immediately deduct 100% of the cost of eligible property placed in service after September 27, 2017, and before January 1, 2023, after which it will be phased downward over a four-year period: 80% in 2023, 60% in 2024, 40% in 2025, 20% in 2026, and 0% rate will apply in 2027 and later years.

The immediate expensing and bonus depreciation provisions are intended to increase business expansion in the U.S. These changes will also provide an incentive to Canadian businesses that want to expand their activities in the U.S. via a U.S. structure, or enter the U.S. market for the first time.

It is important to note that when both 100% the bonus depreciation and the Section 179 deduction are available for the same asset, it is generally more advantageous to claim 100% bonus depreciation, because there are no limits on it.

### Qualified Property

Qualified property for Section 179 and bonus tax depreciation is defined as property that you placed in service during the tax year and used predominantly (more than 50%) in your U.S. trade or business. Property that you placed in service during the tax year and then disposed in the same year does not qualify for the deductions. Similarly, property converted to personal use in the same tax year that it was acquired will not qualify for the deductions.

Qualified property includes computer systems, computer software, vehicles, machinery, equipment, and office furniture.

Note that the above U.S. tax depreciation rules are applicable to both U.S. domestic and foreign-owned entities.

### Bad Debts and Worthless Stock Deductions

As indicated above, companies are facing the challenges of supply Chain issues brought on by the COVID-19, inflation and rising interest rates, should review and evaluate whether they should claim tax losses in 2022 on accounts receivables and worthless assets, or defer to future years.

For U.S. tax purposes, business bad debts can be wholly or partially written off. If a business bad debt is only partially worthless, and is recoverable in part, then the worthless portion is deductible to the extent it is written off during the tax year in the accounting records. A complete write-off requires that the debt is wholly uncollectible as of the end of the year.

Whether a debt is wholly or partially worthless is a question of fact, requiring consideration of all the relevant evidence, including the debtor's financial condition and the value of the collateral secured by the debt. A debt becomes worthless when there is no longer any chance the amount will be collected.

In addition, with signs of a possible recession looming, businesses should consider claiming losses in 2022 for investment in insolvent U.S. subsidiaries. The subsidiaries must be at least 80% owned in order to claim these losses.

### Expiry of Full Deduction for Business Meals

The temporary full deduction for business meals provided for in the "Consolidated Appropriations Act, 2021" will expire at the end of 2022. This is an increase from the regular 50% deduction limit for tax years before 2021 and after 2022. This benefit was intended as a form of stimulus for restaurants, many of which were hit hard during the pandemic. In order to get the 100% deduction the expenses must be paid or incurred during calendar year 2022 for food and beverages provided by a restaurant, regardless of the corporation's fiscal year.

### Control the Timing of Income and Deductions to your Tax Advantage

Smart timing of income and expenses can reduce your tax liability and poor timing can unnecessarily increase it. When you are expecting a loss in the current year, deferring income to next year may be a good idea. Why? Because it will defer tax in the loss year, which is usually beneficial. For example, there will be no cash tax in the current year by virtue of the loss and your company will get a tax benefit when those losses are carried forward to offset taxable income in future year(s).

### Net Investment Income Tax (NIIT)

The NIIT rate is 3.8% on the investment income that typically applies only to high-income taxpayers (see below). The tax applies to individuals, estates and trusts, but certain income thresholds (depending on filing status) must be met before the tax takes effect. For example, the tax applies to all investment income reported on a U.S. return, but only if a single individual has modified gross income above \$200,000 and above \$250,000 for a married couple. Note that this tax is an additional tax to regular income tax liability.

Investment income includes dividends, interest and capital gains. It can also include income from rental properties, capital gain distributions from mutual funds, and even royalty or annuity income.

Note that the NIIT does not include wages, self-employment income, unemployment compensation, Social Security benefits, or alimony.

### We Can Help

Your MG advisor can help you review your personal or business tax situation and help you decide which steps you can take before the year-end to help you with the taxes that you will pay in 2022.

A memorandum of this nature cannot be all-encompassing and is not intended to replace professional advice. Its purpose is to highlight tax planning possibilities and identify areas of possible concern. Anyone wishing to discuss the contents or to make any comments or suggestions about this TaxTalk is invited to contact one of our offices.

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