2023 Year End Guide – Business Incentives & Tax Credits

Employee Retention Credit

The employee retention credit (ERC) is a refundable payroll tax credit for wages and health plan expenses paid or incurred by an employer (1) whose operations were either fully or partially suspended due to a COVID-19-related governmental order; *or* (2) that experienced a significant decline in gross receipts during the COVID-19 pandemic. The ERC has arguably been one of the most valuable provisions originating under the Coronavirus Aid, Relief, and Economic Security Act — the CARES Act — offering significant payroll tax relief for employers who kept employees on their payroll and continued providing health benefits during the COVID-19 pandemic.

Eligible employers can file a claim retroactively until the statute of limitations closes on April 15, 2024, for the 2020 ERC and April 15, 2025, for the 2021 ERC. Note that the U.S. government has repeatedly revised the requirements for U.S. taxpayers to claim the ERC since its initial codification into law. As a result, many eligible taxpayers have been uncertain as to whether they may properly claim this often-valuable tax credit.

Employers should be certain that one of the two paths for eligibility is satisfied:

- Gross receipts in a calendar quarter were less than 80% of the gross receipts for the corresponding quarter in 2019; or
- Business operations were fully or partially suspended during the calendar quarter because of orders from a governmental authority due to COVID-19.

Most eligibility disputes involve the partial suspension test. While most businesses were adversely impacted by COVID-19 related to government actions, not all are eligible for ERC under this provision. To be eligible under the partial suspension test, the suspension must have been material.

Identifying the relevant government orders is another common issue. Qualifying orders must have been mandatory, in effect, and must have caused a suspension of operations for the entire period during which the employer paid the wages supporting the ERC claim.

Also, because the ERC was intended to benefit small businesses, requirements exist that all businesses under common owners be aggregated into a single employer. This rule prevents large businesses from splitting into many entities to qualify. The same aggregation rule used to determine the size of an employer is applied to determine whether the employer experienced a partial suspension that was more than nominal.

In response to mounting concerns over a surge in improper claims for the ERC, on September 14, 2023, the IRS announced an immediate moratorium on processing new claims for the pandemic-era relief program. The moratorium, effective until at least the end of the year, aims to protect businesses from scams and predatory tactics. While the IRS continues to process previously filed ERC claims received before the moratorium, the agency warns that increased fraud concerns will result in longer processing times.

However, the pause on processing new claims does not modify the statute of limitations that expires on April 15, 2024, for wages paid in 2020. Therefore, an employer considering a new request for a legitimate ERC claim should proceed after carefully reviewing Information Releases 2023-169 and 2023 - 170, which the IRS released on September 14, 2023. For employers who would like to make a change to a pending claim that has not been processed or paid, the IRS is expected to issue guidance in the near future.

The IRS has also intensified its focus on reviewing ERC claims for compliance concerns, including conducting audits and criminal investigations on promoters and businesses submitting dubious claims. Hundreds of criminal cases are currently under investigation, and thousands of ERC claims have been referred for audit. Those with pending claims should expect extended processing times, while those yet to file should review the guidelines and consult trusted tax professionals.

As the IRS continues to refine its efforts to assist businesses facing questionable ERC claims, it advises businesses to carefully consider their situation and explore the options available to them. The IRS reminds anyone who improperly claims the ERC that they must pay it back, possibly with penalties and interest.

The IRS has stated that it will develop an ERC settlement program in late 2023 for employers that already received an ERC payment based on a claim now believed by the employer to be overstated. Under the settlement program, employers will be able repay the excess ERC amounts while avoiding penalties and other future compliance actions.

Additionally, to assist businesses affected by aggressive promoters, the IRS is developing a special withdrawal option for businesses that have filed an ERC claim but have not yet had it processed. Details of this program are expected to be announced in the coming months.

Given the increased IRS scrutiny of ERC claims, employers should reevaluate their ERC positions regarding eligibility and the amount of the claim. The IRS recommends that taxpayers seek advice from a trusted tax advisor.

Employers that have already filed a claim not prepared by a trusted tax advisor should verify whether any of the red flags or other concerns listed in the two IRS Information Releases apply to their situation. If they do, they should have any already submitted claim reviewed by a trusted tax professional. If the review does not support the claim as it was filed, corrective action should be pursued.

Credit for Increasing Research Activities: Proposed Changes to Form 6765 and Exam Environment

The IRS on September 15, 2023, released a preview of proposed changes to Form 6765, Credit for Increasing Research Activities, which taxpayers use to claim the research credit. The proposed changes, likely to become effective at the beginning of the 2024 tax year, include a new Section E with five questions seeking miscellaneous information and a new Section F for reporting quantitative and qualitative information for each business component, required under Section 41 of the Internal Revenue Code.

The IRS has also requested feedback on whether Section F should be optional for some taxpayers, including those with qualified research expenditures that are less than a specific dollar amount at a controlled group level; with a research credit that is less than a specific dollar amount at a controlled group level; or that are Qualified Small Businesses for payroll tax credit purposes.

It is important to note that if Section F were made optional for certain taxpayers, it would not exempt them from the requirement to maintain books and records or provide Section F information in a similar format, if requested; and it would not apply to amended returns for the research credit.

Examination Environment

Currently, the IRS receives a significant number of returns claiming the research credit, which requires substantial examination resources from both taxpayers and the IRS. To ensure effective tax administration for this issue, the IRS aims to clarify the requirements for claiming the research credit by considering all feedback received from stakeholders before finalizing any changes to Form 6765.

In response to ongoing concerns of improper claims of the research credit, the IRS has intensified its focus on reviewing these claims for nonconformities, including conducting a greater number of audits. Navigating the complexities of the research credit can be challenging, especially with the increased scrutiny, advancement of recent case law, and the newly implemented IRS compliance measures in place.

It is important for taxpayers to accurately determine eligibility, validate and properly record contemporaneous documentation to support research credit claims, and defend against examinations. Taxpayers should work with a trusted tax advisor to support compliance with IRS regulations and proper eligibility for the research credit.

Tax Credit Monetization

The signing of the Inflation Reduction Act on August 16, 2022, marked the largest-ever U.S. investment to combat climate change, allocating $369 billion to energy security and clean energy programs over the next 10 years, including provisions incentivizing the manufacturing of clean energy equipment and the development of renewable energy generation.

Overall, the act modifies many of the current energy-related tax credits and introduces significant new credits and structures intended to facilitate long-term investment in the renewables industry. Capital investments in renewable energy or energy storage, manufacturing of solar, wind, and battery components, and the production and sale or use of renewable energy are activities that could trigger one of the over 20 new or expanded IRA tax credits. The IRA also introduced new ways to monetize tax credits and additional bonus credit amounts for projects meeting prevailing wage and apprenticeship, energy community, and domestic content requirements.

45X – Advanced Manufacturing Production Tax Credit

The 45X Advanced Manufacturing Production Credit is a new production tax credit meant to encourage the production and sale of energy components within the U.S., specifically related to solar, wind, batteries, and critical mineral components. To be eligible for the credit, components must be produced in the U.S. or a U.S. possession and sold by the manufacturer to unrelated parties.

The Department of Energy has released a full list of eligible components as defined by the IRA, with specific credit amounts that vary according to the component. Manufacturers can also monetize 45X credits through a direct payment from the IRS for the first five years under Internal Revenue Code Section 6417.

They may also transfer a portion or all of the credit to another taxpayer through the direct transfer system Section 6418 election. The 45X credit is a statutory credit with no limit on the amount of funding available; however, the credit will begin to phase out in 2030 and will be completely phased out after 2033. Manufacturers cannot claim 45X credits for any facility that has claimed a 48C credit.

48C – Qualifying Advanced Energy Project Tax Credit

In 2009, Congress enacted the America Recovery and Reinvestment Act, which included the 48C tax credit for qualifying advanced energy project investments. This credit initially applied to investment in facilities that produced various renewable energy assets and other property that reduced greenhouse gas emissions.

The Inflation Reduction Act provided new funding for the 48C credit and expanded the definition of qualified advanced energy projects to include facilities that produce components used in carbon capture, utilization and storage, energy grid modernization, renewable fuel generation and refinement, components of electric vehicles, and recycling facilities for eligible components. Manufacturers investing to construct, re-equip, or expand a facility that meets the definition of a qualified advanced energy project can apply for an allocation of the 48C credit.

The IRS and Department of Energy will award $10 billion in 48C credits via a two- step application process, with $4 billion reserved for projects located in energy communities. The base amount of the 48C credit is 6%, but the total credit can be as high as 30% if applicants meet prevailing wage and apprenticeship requirements. Recipients can claim 48C credits on federal corporate income taxes for a percentage of eligible investment costs placed into service during the current tax year. Corporations or flow-through entity shareholders who lack the ability to utilize the credits may sell them for cash under the new IRA credit transfer provisions.

Taxpayers applying for 48C allocation must submit an initial concept paper as well as a full application to be reviewed by the IRS and DOE. The first round of 48C allocation will award $4 billion by March 31, 2024. While the current round's concept paper deadline has already passed, there will be additional rounds for the remaining $6 billion of funding in 2024 and beyond.

6418 – Transferability

Under IRC Section 6418, certain renewable energy tax credits can now be transferred by companies generating eligible credits to any qualified buyer seeking to purchase tax credits. Through credit transfers, taxpayers have the option to sell all or a portion of their credits in exchange for cash as part of their overall renewable energy goals if they are not able to fully utilize the benefit. Companies are able to purchase these credits at a discount, with the sale proceeds improving the economics of clean energy development.

The market rate for the sale of credits will be highly dependent on the type of credit being transferred, as well as the substantiation and documentation related to the seller's eligibility for the credit taken and any bonus credit amounts claimed. The current rates seen in the market for transferring credits is around $.90 to $.94 per $1 of credit, but these amounts are subject to change based on specific fact patterns for each individual transaction and the overall market trend.

Taxpayers considering buying or selling tax credits that are transferable under the IRA should be looking ahead and forecasting their potential tax liability and resulting appetite for buying and selling credits. These credits can be transferred and utilized against estimated quarterly payments as soon as transfer agreements are finalized. This expedited reduction in cash outlay for the buyer and monetization of credits for the seller is a consideration that should be taken into account by taxpayers interested in entering the market of transferring credits. Note that taxpayers must be able to effectively utilize general business credits for this opportunity to be worthwhile.

Bonus Credits

The Inflation Reduction Act not only introduced new and expanded credits for investment in and production of renewable energy and its related components, it also included provisions for bonus credit amounts subject to meeting specific requirements. The prevailing wage and apprenticeship requirement is a 5x multiplier for certain credits that can bring the credit rate from 6% to 30% by paying prevailing wages to all labor related to the construction, installation, alteration, and repair of eligible property. Additionally, taxpayers must ensure that a certain percentage of these labor hours are performed by a qualified apprentice. Other common credit adders available for taxpayers that meet energy community and domestic content requirements provide a 10% adder to the base rate of the credit. Taxpayer documentation will be required to substantiate the claim of these bonus credit amounts and will need to be presented to a buyer in the event that these credits are transferred under 6418.

Taxpayers that have current or planned investments or activities for which they plan to utilize the prevailing wage and apprenticeship multiplier should be planning a documentation strategy and procedure. In the event of an IRS audit or transfer of these credits, taxpayers will be required to substantiate the wages paid to laborers as well as the number of hours performed by registered apprentices. Depending on the size and amount of labor involved in qualified investments or production, documentation for PWA as well as the domestic content requirements will likely be a highly burdensome task if not planned accordingly at the outset of a project.

New Markets Tax Credits

The U.S. Treasury's CDFI Fund recently released its annual allocation of New Markets Tax Credits (NMTCs). The federal New Markets Tax Credit (NMTC) program was established in 2000 to subsidize capital investments in eligible low-income census tracts. The subsidy provides upfront cash in the form of NMTC-subsidized loans fixed at below-market interest (2.5-3.5%). The loan principal is generally forgiven after a seven-year term resulting in a permanent cash benefit. Funding for these subsidized loans is highly competitive and expected to be depleted quickly.

Taxpayers across many industries can be good candidates to participate in the NMTC program.

Recipients are evaluated based on the community impact derived from the investments (e.g., job creation, community services provided, etc.). Ideal projects have at least $7 million in capital expenditure. These initial questions will help interested parties assess if a project is viable for NMTC.

- Address of proposed project
- High-level project description
- Status of construction/timeline of CAPEX (midstream projects are permitted)

- Estimate of direct jobs to be created by project (within 3 years of PIS)

Taxpayers with ongoing or planned capital investments for late 2023 or early 2024 that are eligible to receive NMTC financing should begin reaching out to community development entities. The latest round of allocation was announced on September 22, and early outreach provides qualified active low-income community businesses a strong advantage in securing this financing due to the program's competitive nature and limited funds.