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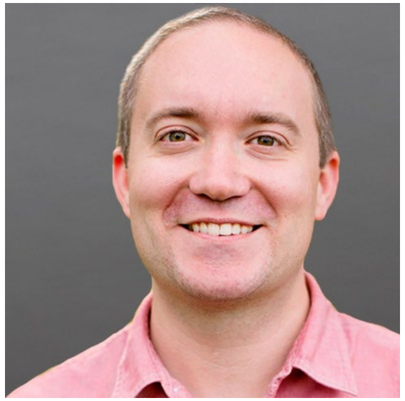
2023 Executive Briefing

Certified B Corporation

Disclaimer

Each individual and business will be impacted differently by these prospective changes. This discussion is not a substitute for professional advice on your specific situation. We encourage you to reach out to your own professional advisor to gain advice for your unique situation.

Presenters



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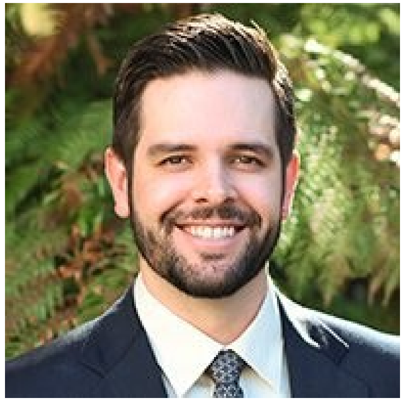

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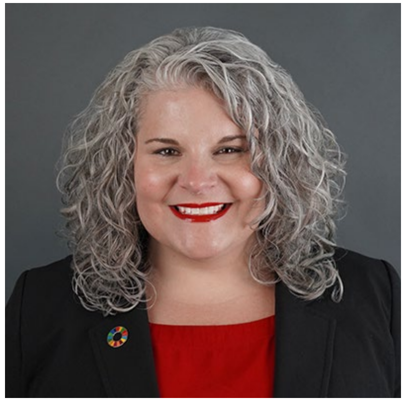

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Agenda for Today

- Updates to R&D Credit and Mandatory R&D Expense Capitalization
- Lease Accounting Update
- Sustainability Disclosures are Coming!
- International Tax Overview

Updates to R&D Credit and Mandatory R&D Expense Capitalization

presented by Cole Marr

R&D Credit Update

- IRC Sec. 41 provides a general business credit of 6-12% of qualifying expenditures
  - Many states also have credits: California is often comparable with federal credit
- New and improved products & processes paid for by the company
- Must meet the “Four-Part Test”:
  1. Scientific in Nature
  2. Process of Experimentation
  3. Technical Uncertainty
  4. Permitted Purpose
- Qualified Small Businesses can allocate the R&E Credit to offset up to $250,000 in payroll tax
  - Increases to $500,000 for tax year 2023

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R&D Credit Update

WAGES

Typically the largest category of expenses. Wages for direct involvement, as well as direct supervision and direct support are includeable.

- Engineers
- Managers with Technical Input
- Technicians
- Production Personnel
- QA/QC

SUPPLIES

Materials consumed in the R&D process. Can be large expense category in certain industries.

- Prototypes/Samples - Built or Shipped to US
- Materials used to test process improvements
- Pilot Runs
- R&D Software Subscriptions

CONTRACT RESEARCH

Often used to supplement capability or provide highly technical expertise for a specific project.

- Testing & Certification
- Software Development
- Outsourced Engineering
- Patent Attorney Expenses

R&D Credit – Disclosure Changes for 2023

- IRS Considering Changes to Form 6765, Credit for Increasing Research Activities, for 2023
- Potential changes include disclosure of detailed information:
  - Number of business components
  - Identify each business component & provide a description
  - Provide expenses by business component
- This disclosure will result in significant additional effort for most R&D credit claims

Section 174 Capitalization and Amortization

- Background: TCJA require Capitalization and amortization of R&E costs for tax years beginning after 12/31/21
  - Previously this was optional, though once elected could only be revoked with consent
  - While many states conform to federal, California is one that does not conform (no need to amortize)
- Capitalization is mandatory
  - While Sec. 41 (R&E Credit) is a subset of Sec. 174 (Research and Experimental Expenditures), claiming no tax credit will not relieve the taxpayer from the requirement to identify and quantify Sec. 174 expenses
- Amortization
  - 5 years (15 years for expenses that are attribute to foreign research) using midyear convention
  - For 2022, this means only 10% of US expenses and 3.33% of foreign are amortized

Section 174 Capitalization and Amortization

Specified research and experimental expenditures under Section 174 are R&D expenditures paid or incurred by the taxpayer during such taxable year in connection with the taxpayer's trade or business

IRS regulations or guidance lacking for accurate determination of Sec. 174 expenditures

- Generally, the definition of eligible activity from Section 41 – Research and Experimentation Tax Credit will likely be used
- Amounts included under Section 174 are broader than Section 41

Automatic change in accounting method – statement in lieu of Form 3115 – Application for a Change in Accounting Methods

R&D Credit Update

- Significant differences between Sec. 41 R&D Expenses and Sec. 174 R&D Expenses
- Guidance on IRS definitions of Sec. 174 expenses expected by March/April 2023

Section 41 – Research Tax Credit

- Portion of taxable wages
- Direct Supplies used in the conduct of R&D
- US eligible R&D contractor expenses
- Small portion of patent expenses
- Portion of US R&D software development cost
- No utilities
- No depreciation

Section 174 – R&D Capitalization

- Gross wages for R&D Personnel, portion of gross wages for personnel outside the R&D groups
- Any supplies used by the R&D Team
- US and International R&D Contractors
- Larger portion of patent expenses
- ALL software development costs
- Allocated cost of utilities to R&D
- Depreciation allocatable to R&D

Lease Accounting Update

presented by Joe Brunel

Agenda

- Lease Accounting Overview
- Six Steps to Success
- Discount Rates
- Financial Statement Presentation
- Accounting Policy Adoption
- Lessee Footnote Disclosure Requirements
- SSF Service Offerings

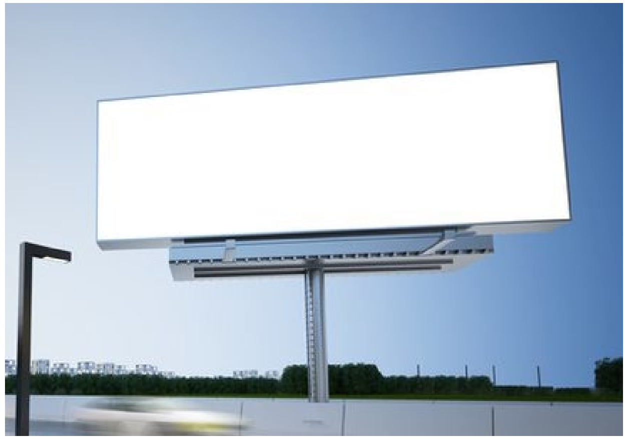
Lease Accounting Overview

EFFECTIVE DATE	
Public and international companies:	Private organizations:
FISCAL YEAR AFTER DEC. 15, 2018	FISCAL YEAR AFTER DEC. 15, 2021

- ASC 842 replaces ASC 840
- In ASC 840, capital leases were recorded on the balance sheet, while operating leases were disclosed as a footnote in financial statements. These “Off – Balance Sheet” operating leases were thereby excluded from important financial ratios that would allow stakeholders to evaluate a company’s performance
- The goal of ASC 842 is to overcome this blind spot and provide increased visibility into leasing obligations on financial statements

What is a Lease Under ASC 842?

- Lessee must have the **right to control** the use of the asset.
  - Control exists if you have both of the following:
    - Right to obtain substantially all the economic benefits through the agreement term
    - Right to direct the use of the **identified asset**
- Lessor does not have substantial substitution rights
- Must be a physical asset explicitly or implicitly identified



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Six Steps to Success

1. Review Your General Ledger Accounts
2. Inventory Contracts: Review Key Terms and Payments
3. Separate Fixed and Variable Payments
4. Consider Policy Elections and the Election of Practical Expedients
5. Evaluate Contracts to Determine Financing Lease vs. Operating Lease Classification
6. Evaluate Financial Statement Adoption Options

Link to full article >

Discount Rates

With the adoption of ASC 842, companies will expect to see a significant increase in the number of leases reported on their Balance Sheet. Selecting and estimating the lease discount rate will have an impact on the lease liability and right of use asset on the Balance Sheet. For a lessee, the discount rate for the lease is the rate implicit in the lease unless that rate cannot be readily determined. In that case, the lessee is required to use its incremental borrowing rate.

- Implicit Rate (IR) – defined as the rate of interest at a given date that causes the aggregate present value of (1) the lease payments and (2) the amount that a lessor expects to derive from the underlying asset following the end of the lease term.

Discount Rates

- Incremental Borrowing Rate (IBR) – defined as the rate of interest that a lessee would have to pay to borrow on a collateralized basis over a similar term an amount equal to the lease payments in a similar economic environment.
- Common myths about IBR
  - IBR is the interest rate on an easily accessible line of credit – this was allowable under ASC840, but under ASC842 lessees must use a collateralized rate.
  - IBR is the weighted average interest rate that a lessee pays on its other debt – lease terms and other economic characteristics will vary precluding use of a blended rate.
  - A lessee can use the same IBR for all of its leases – ASC 842 applies on the individual lease level and IBR needs to be determined for each individual lease.

Discount Rates

- Incremental Borrowing Rate Examples:
  - Rate on Existing Debt
  - Borrowing Rate of Similar Entities
  - Rate Quoted by a Lender
- Risk-Free Rate (RFR): Practical expedient alternative for private companies. The RFR is the rate of a zero-coupon U.S. Treasury instrument using a period comparable with the lease term.
- Discount Rate Reassessment: Lessees are required to reassess the discount rate when there is a modification (change to the terms and conditions of a contract, terminates the right to use an underlying asset, or extends/shortens the lease term).

Lessee Financial Statement Presentation

Balance Sheet Presentation

- Right of Use Asset – separated for both financing and operating leases
- Lease Liability – both current and non-current, separated for both financing and operating leases

Income Statement Presentation

- Financing lease interest and amortization of ROU is presented separately consistent with similar assets.
- Operating lease expense is reported as one expense in the statement of operations.

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Lessee Financial Statement Presentation

Cash Flow Statement Presentation

- Financing lease interest is reported as an operating activity and the repayments of the principal portion as financing activity.
- Payments for operating leases are presented as an operating activity.

Foreign Currency Presentation

Re-measurement method

- ROU asset is a nonmonetary asset therefore the ROU asset is re-measured using the exchange rate as of the lease commencement date (Historical Rate).
- The Lease Liability is a monetary asset therefore the liability is re-measured using the current month end exchange rate.

Account Policy Adoption & Election Disclosures

- Upon adoption of ASC 842, lessees will need to consider and draft appropriate accounting policies surrounding treatment of leases (both financing and operating), election of practical expedients, and assumptions regarding discount rate application.
- How a lease arrangement is determined (typically at inception) along with operating lease vs. finance lease classification and measurement (including where components are included in the Balance Sheet)
- Discount rates (which rate used, how rate is determined)
- Measurement of ROU (how it is calculated and what is included)
- Exclusion of short-term leases (less than 12 months)

Lessee Footnote Disclosure Requirements

A lessee shall disclose qualitative and quantitative information about **all** the following:

- The significant judgements made in applying the requirements including but not limited to:
  - The determination of the discount rate
  - Election of practical expedients and which class or classes of underlying assets it has elected to apply the practical expedient. (Accounting Policy)
  - Election of the recognition exemption for short-term lease 12 months or less. (Accounting Policy)
  - Other items such as variable lease payments, terms and conditions of residual lease guarantees and restrictions or covenants imposed by leases.
  - Allocation of consideration in a contract between lease and non-lease components. (Accounting Policy)

Lessee Footnote Disclosure Requirements

- The amounts recognized in the financial statements for the ROU and lease liabilities for financing leases, operating leases and short-term leases separately.
- A lessee shall aggregate or disaggregate disclosures to enable users of financial statement assess amount, timing and uncertainty of cash flows.
- Segregate disclosures between financing and operating leases:
  - Cash paid for amounts included in the measurement of lease liabilities.
  - Supplemental noncash information on lease liabilities from obtaining ROU assets.
  - Weighted-average remaining lease term.
  - Weighted-average discount rate.
  - The minimum lease amounts of the first five years and the total of the remaining years.

Recap

- ASC 842 is effective beginning January 1, 2022, for calendar year-end private companies and nonprofits. This presentation summarized some of the topics to understand and consider upon adoption of the new standard. But each Company's situation will be difference.
- SSF is here to help! Reach out with questions, or if you need support, etc. www.ssfllp.com/lease-accounting-advisory

SEC, ISSB, and IRA...*Oh My!*

Sustainability disclosures are coming.

presented by Jennifer Harrity-Cantero

SEC's Proposed Climate-Related Disclosure Rules

- New rule that would require publicly listed companies to include certain climate change disclosures in their registration statements and periodic reports
  - SMEs that supply products to publicly traded companies should expect this demand for standardized and verified emissions reporting to trickle down to them sooner than later
  - Final ruling expected by the end of April 2023
  - A similar proposed ruling is coming soon for Human Capital Disclosures

International Sustainability Standards Board (ISSB)

- Created by IFRS Foundation
- Founded on November 3, 2021
- Governs and incorporates SASB standards
- Harmonization of Global ESG/Sustainability Frameworks — Setting a global standard for sustainability
- ISSB is also expected to finalize rules on climate disclosures in 2023

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Inflation Reduction Act (IRA)

- Signed into law August 2022
- Injects more than $370 billion into climate and energy programs
- Would cut US greenhouse gas emissions about 40% below 2005 levels by 2030
- $60 billion to accelerate domestic production of solar panels, wind turbines and batteries, as well as support critical minerals processing

Top 5 Ways the IRA Can Help Businesses Save

- **Extended:** Production Tax Credit (PTC), Energy Investment Tax Credit (ITC), and the Carbon Capture Credit
- **Added:** new Production Tax Credit for clean hydrogen produced after December 31, 2022, at a qualifying facility that starts construction before January 1, 2033. / also, option to elect to claim the ITC in lieu of the new production tax credit
- **Added:** new Advanced Manufacturing Production Credit to incentivize domestic production and sale of components used in solar, wind, and storage projects (e.g., solar modules, solar-grade polysilicon, inverters, battery cells, blades, and towers) and critical minerals
  - Includes facilities that equip or expand certain manufacturing facilities in the clean energy sector.

Top 5 Ways the IRA Can Help Businesses Save

- Includes: new tax credits for zero-emissions nuclear power production and transportation fuels with lower emissions rates
- Includes: a 10% bonus credit when domestic content requirements are satisfied and a separate 10% bonus credit for qualifying facilities located in enhanced energy or low-income communities

Top 5 Ways the IRA can help Homeowners Save

- Rebate of up to **$8,000 to install heat pumps** that can both heat and cool homes, and a rebate up to $1,750 for a heat-pump water heater
- Offers up to **$4,000 rebate for electrical panel upgrade** / rebate up to **$2,500 for improvements to electrical wiring**
    - Additional tax credit installation for solar battery systems – least three kilowatt-hours of capacity
- Rebate up to **$1,600 to insulate and seal a house**

Top 5 Ways the IRA can help Homeowners Save

- Revives **30% tax credit for installing residential solar panels** and extends the program until Dec. 31, 2034
  - Tax credit would decline to 26% for solar panels put into service after Dec. 31, 2032, and before Jan. 1, 2034
- Tax credits up to **$7,500 for purchase of a new electric vehicle** / **$4,000 for lower- and middle-income families who purchase a used EV**

How SSF Can Help

Your Outsourced Sustainability Department

Sustainability Process Approach

ASSESS

The first step is to assess the current organizational landscape to identify key opportunities and threats. This phase enables organizations to establish baselines and pinpoint where to intervene for maximum impact.

ACT

You can now begin putting initiatives into action that demonstrate the nexus between sustainability and good business practices to build credibility and generate momentum.

ARTICULATE

Once you have a structure in place for measuring, managing, and mitigating your sustainability impacts, SSF can collaborate with your communications and marketing teams to integrate your sustainability performance into core messaging and branding.

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Frameworks vs. Goals

Public Facing & Consumers	Investors & Shareholders
Certified B Corporation	IMPAKT IQ™
SCIENCE BASED TARGETS	SASB STANDARDS Now part of IFRS Foundation
SUSTAINABLE DEVELOPMENT GOALS	TCFD TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES
CLIMATE NEUTRAL CERTIFIED	CDP™

Integrated Assistance

- Collaboration between our accounting, business advisory, sustainability consulting can support clients in planning and budgeting for the implementation of sustainability initiatives so that they are integrated into the ERP process
- Think of us as your outsourced sustainability department; we can step in if you don't have a dept or provide support to your existing team
- Reach out with questions, or if you need support, etc.
  ssfllp.com/sustainability

International Tax Overview

presented by Ming Li

International Tax Overview

- In a worldwide system of taxation, a jurisdiction imposes tax on its residents on all income earned both at home or abroad. Foreign tax credits (FTCs) is given to mitigate double taxation.
- In a territorial system of taxation, a jurisdiction imposes tax only on income earned at home. Usually there is no domestic tax on foreign income.
- Most jurisdictions have a hybrid system with components of both worldwide and territorial systems.

International Tax Overview

The U.S. taxation of international transactions is generally considered either “outbound” and “inbound” :

- Inbound: Foreign Persons Investing in the U.S.
- Outbound: U.S. Persons Investing Overseas

International Tax Overview - Inbound

- Foreign persons are taxed (and possible branch profits tax) on net income that is deemed to be effectively connected with carrying on a U.S. trade or business, or on the gross amount of their fixed or determinable income that is deemed sourced to United States

International Tax Overview - Outbound

Pre-TCJA: U.S. persons are subject to tax on all income earned at home or abroad, except the deferral of income earned by a foreign subsidiary, subject to anti-deferral rules (e.g., Subpart F), and double taxation was mitigated by foreign tax credits (FTCs).

Post-TCJA: Movement towards a Quasi-Territorial Tax System and Tax Deferral is effectively ended by combination of the following:

- Foreign Dividend Received Deduction (DRD) (C-Corp Only)
- Anti-Deferral Provision – Global Intangible Low Taxed Income (GILTI)
- Foreign Derived Intangible Income (FDII) (C-Corp Only)
- Base Erosion Anti-Abuse Tax Provision (BEAT)

Common International Tax Forms

FinCEN Form 114 – Foreign Bank Account Report (“FBAR”)

A U.S. PERSON that has a FINANCIAL INTEREST or SIGNATORY AUTHORITY over FOREIGN FINANCIAL ACCOUNTS if the aggregate value of the foreign financial accounts EXCEEDS $10,000 at any time during the calendar year.

Deadline – 4/15

- Must be filed electronically
- Not filed with the tax return
- Automatic Extension: 10/15

Common International Tax Forms

Form 8938: Statement of Specified Foreign Assets

A specified individual that has an interest in specified foreign financial assets and the value of those assets is more than the applicable reporting threshold.

- Filed with tax return

	Living In the U.S.		Living OUTSIDE of the U.S.*	
	Highest Balance	Year End Balance	Highest Balance	Year End Balance
Unmarried OR Married Filed Separately	$75,000	$50,000	$300,000	$200,000
Married Filed Jointly	$150,000	$100,000	$600,000	$400,000

Common International Tax Forms

Form 5471: Information Return of U.S. Persons With Respect to Certain Foreign Corporations

Form 5471 is used by certain U.S. persons who are officers, directors, or shareholders in certain foreign corporations. Attach to your income tax return and file both by the due date (including extensions).

- Applicable to both individual or entity tax returns
- GILTI, FDII is reported by combination of various forms and schedules from Form 5471
- The penalties for not filing Form 5471 start out at $10,000 and go up exponentially

Other Common International Tax Forms

1. Form 8833 - Treaty Based Disclosure Position
2. Form 2555 - Foreign Earned Income Exclusion
3. Form 5472 - Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business
4. Form 8865 - Return of U.S. Persons With Respect to Certain Foreign Partnerships
5. Form 8858 - Information Return of U.S. Persons With Respect To Foreign Disregarded Entities
6. Form 3520 - Return for Foreign Trusts and Receipt of Certain Foreign Gifts
7. Form 3520A - Annual Information Return of Foreign Trust With a U.S. Owner

Current Development

- New Corporate AMT on BMT:
  - The recently enacted Inflation Reduction Act imposes a corporate alternative minimum tax (AMT) based on financial statement income (book minimum tax, or BMT).
  - The BMT is effective for tax years beginning after December 31, 2022.
  - Imposes a 15% minimum tax on adjusted financial statement income (AFSI) for corporations with average annual AFSI over a three-tax year period in excess of $1 billion.
  - BMT increases a taxpayer’s tax only to the extent that the tentative minimum tax exceeds regular tax plus base erosion and anti-abuse tax (BEAT).

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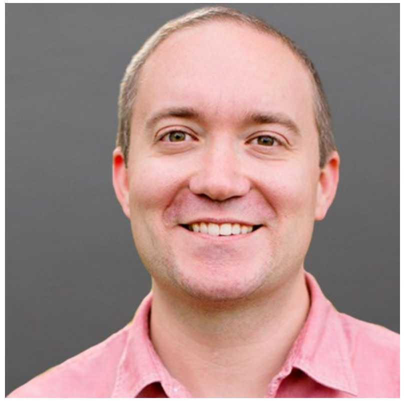

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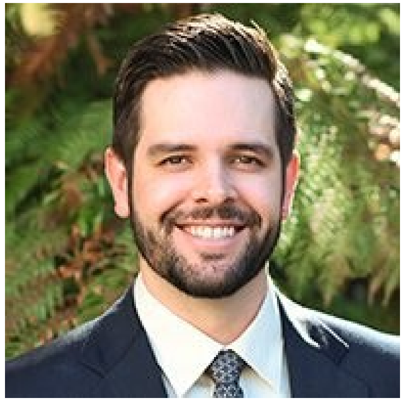

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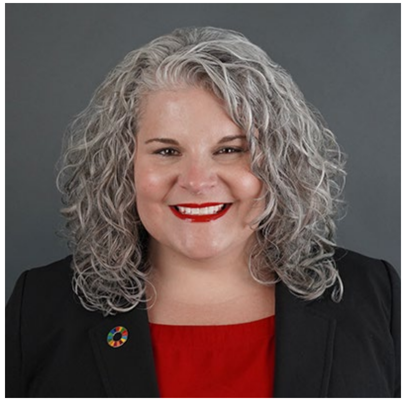

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Thank you!

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