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2020 Business Year-End Tax Planning Tips

Year-end planning for 2020 takes place against the backdrop of a turbulent year for businesses. The following is a brief overview of many year-end tax saving strategies incorporating the implications of the pandemic, associated loans and how they will affect taxpayers with businesses. Some are straightforward, while others require more analysis and review to tailor them to your particular tax and financial situation. Please call on us to help you sort through the options and implement strategies that make sense for you and your situation.

Take Advantage of Refund Opportunities.

Provisions within the Tax Cuts and Jobs Act (TCJA) and the Coronavirus Aid, Relief, and Economic Security Act (CARES) provide opportunities for businesses to increase their cash flow by receiving refunds of prior taxes paid in a variety of ways.

AMT Refunds. The TCJA repealed the corporate alternative minimum tax and allows corporations to claim their unused AMT credits in tax years beginning in 2018—2021. The CARES Act accelerated this timeline and allows corporations to claim all remaining credits in 2018 or 2019. There are several options for filing the claim for refund. The fastest way is to file a tentative claim for refund on Form 1139, which must be done by December 31, 2020.

Net Operating Losses. The CARES Act contains a provision enabling businesses to apply current losses against previous income to generate immediate refunds. NOLs generated in 2018, 2019, or 2020 can be carried back up to five years to generate refunds or prior taxes. If you anticipate losses with your 2020 return, start preparing to file early as you cannot claim an NOL carryback until your 2020 return is filed.

Qualified Business Income (QBI)Deduction. The Qualified Business Income Deduction, also known as the Section 199A deduction, allows eligible business owners to claim a tax deduction worth up to:

- 20% of their qualified business income (QBI), **plus**
- 20% of qualified real estate investment trust (REIT) dividends, **and**
- 20% of qualified publicly traded partnership (PTP).

This is one of the few provisions under the *New* Law that is set to expire after 2025.

Qualified Business Income” (QBI) is essentially net profits from “any” pass-through trade or business, subject to certain limitations and exclusions:

1. Certain personal service businesses known as “Specified Service Trade Or Businesses” and

2.The trade or business of performing services “as an employee.”

A “Specified Service Trade or Business” (SSTB) is any trade or business activity where the principal asset of such trade or business is the reputation or skill of one or more of its employees. Certain industries are also automatically classified as an SSTB due to the nature of the services rendered (i.e. law, accounting, performing arts, consulting, etc).

Qualifying owners with total taxable income under $163,300 or $326,600 (if filing jointly) may qualify for the full 20% deduction. Owners of SSTB’s may qualify for the full 20% deduction if taxable income does not exceed $160,700 or $321,400 (if filing jointly). Above these limits, the ability to claim the deduction depends on the precise nature of the business, as the deduction phases out for some businesses.

Choice of Entity

Year-end is a good time to examine the appropriateness of your entity structure to ensure it aligns with your needs and evaluate the possibility of changing your structure.

Business structures differ mainly in how they handle income taxation and owner liability. Many organizations choose a structure that combines pass through income taxation with limited liability for the owners—namely, limited liability companies or S-Corporations.

The tax on self employment earnings increases the Social Security tax burden on income from businesses organized as partnerships or LLCs treated as partnerships and sole proprietorships for federal tax purposes. Since all ordinary income generated and passed through to owners from an active trade or business under the partnership rules are subject to the self employment tax, utilizing an S corporation could minimize the impact.

At issue is how much of the company's profit will be subject to self-employment taxes. As a partnership, the company's profit is subject to self-employment taxes. However, as an S corporation, an owner must take "reasonable compensation" out of the company as W-2 wages which would be subject to payroll taxes, an equivalent of self-employment taxes. Any profit above these wages is not subject to self-employment taxes and are available to be taken out as distributions.

The TCJA drastically reduced the corporate income tax rate to 21%, which is significantly lower than the top individual income tax rate of 37%. In certain cases, business owners may benefit from shifting their operations to a corporate structure.

Equipment and Office Furniture Purchases

If you buy new or used equipment/furniture for your business or make certain improvements to property and place these assets into service before the end of the year, you could be entitled to a federal tax deduction of up to $1.04 million of the costs associated with these purchases/improvements under Section 179 provisions. The TCJA expanded the definition of section 179 property to include qualified improvements to nonresidential real property, which means certain improvement to a building's interior and for improvements such as roofs, HVACs, fire protection systems, alarm systems and security systems now qualify for the deduction. Additionally, most types of equipment and many interior building and leasehold improvements may be eligible for 100% Bonus Depreciation at the federal level. Vermont does not allow for bonus depreciation, meaning that in some cases, there may be differences between federal and state taxable income when bonus depreciation is elected. The deductions are available for new or used equipment purchased or financed and placed into service before December 31, 2020. For further details you can also visit section179.org.

Company Vehicles

Buying a new or used passenger auto for your business can lead to tax breaks. If bonus depreciation is claimed, the first-year depreciation cap is $18,100 for vehicles bought after September 27, 2017, and put in use this year. The second– and third-year caps are $16,100 and $9,700. After that… $5,760. If no bonus depreciation is taken, the first-year regular depreciation ceiling ends up falling sharply to $10,100.

Buyers of heavy SUVs used solely for business can write off the full cost, thanks to bonus depreciation. SUVs must have a gross weight rating over 6,000 pounds.

Additionally, up to 100% of the cost of a pickup truck can be expensed this year. Through a combination of Section 179 and bonus depreciation.

Income Shifting to Children

Paying wages to a child can be a great way to shift income and reduce taxes. Many people don't pursue this option due to misunderstanding the "Kiddie Tax" rules; however, the "Kiddie Tax" only applies to investment income, not earned income such as wages from employment.

The wages paid to a child are deductible if the following criteria have been met:

* The wages are paid for work performed that is related to the parent's trade, or business.
* The child must actually perform the services.
* The wages are actually paid out to the child.
* The compensation being paid must be reasonable for the services being performed.

What are the advantages of doing so?

* First of all, the income paid to your child is either taxed at your child's lower tax rate, or escapes taxation completely if the total amount paid for the year is less than the child's standard deduction ($12,400 in 2020).
* Now that the child has earned income, he/she can make contributions to a retirement plan. This is a great way for you to jump start retirement savings for your child. (Think Roth IRAs).
* And of course you get the deduction at the business level for the amounts paid to your child. You have shifted the income from your higher tax bracket to their lower bracket.

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Accelerate or Defer Income

Cash-method businesses that want to defer income should consider delaying the sending of late-in-the-year invoices, so payment is not received until 2021. In addition, pay as many expenses as feasible by year-end to get the deduction in 2020. Credit cards are considered the same as checks. Accrual-method businesses wanting to defer income should, if possible, hold off on providing goods or services to customers and billing for them until after January 1. In some cases, depending on your business' bottom line, it may make sense to accelerate income into 2020 or defer expenses to 2021.

Deductions on Bonuses for Accrual Basis Businesses

An accrual basis C-corporation can take a 2020 deduction for a bonus not actually paid to its employee until the following tax year if (1) the employee doesn't own more than 50% in value of the corporation's stock, (2) the bonus is properly accrued on its books before the end of the current tax year, and (3) the bonus is actually paid within the first 2 1/2 months of the following year (for a calendar year taxpayer, within the first 2 1/2 months of 2021). For employees who are on the cash basis (for income that was deferred before it was earned), the bonus won't be taxable income until the following year.

Year End Bonuses for Owners

Increasing compensation for a business owner through the payment of a year end bonus is something to consider as a way to help maximize QBID deductions, maximize various tax credits linked to compensation levels, catch up on withholdings for the year to reduce or even eliminate underpayment penalties, and maximize retirement contributions. Deductions won't be allowed for bonuses to an owner-employee unless actually paid out by December 31, 2020.

Retirement Plan Selection

There are several options available to small business owners for employer-sponsored retirement savings plans, including 401(k), SEP IRA, SIMPLE IRA, and profit sharing plans. Plans differ in the amount of eligible employer and employee contributions, investment options available, deadlines for establishment and funding, and ease and expense of setup and administration.

If you're planning to establish a retirement plan for yourself or your employees, it may be beneficial to set it up before year end. In many cases, contributing to a retirement plan before the filing deadline (including extensions) allows a company to take a deduction for these contributions on the current year return as if they were paid by December 31.

In addition, to help offset startup costs associated with the implementation of a retirement plan, eligible employers may claim a tax credit of up to $5,000 per year in each of the first three years of the plan. The credit can also be applied to the year before the plan becomes effective.

Contribute to or Establish a Solo 401(k)

A Solo 401(k) is a tax-advantaged retirement account for employers with no full-time employees other than the business owner and their spouse. Self-employed individuals can contribute up to $19,500 as an "employee contribution" and up to 20% of their net self-employment income as an "employer contribution." The maximum amount a self-employed person can contribute to a Solo 401(k) for 2020 is $57,000. At age 50, the self-employed person can contribute up to an additional $6,500 per year in "catch-up" contributions. Solo 401(k) plans must be established by December 31, 2020 to make contributions for 2020. However, contributions can be made any time up to the filing deadline (including extensions) and still be deducted.

Contribute to or Establish a SEP or SIMPLE IRA

Businesses with employees other than the owner/spouse have additional retirement options. Allocating a larger portion of benefits to retirement rather than increasing employee wages allows a business a deduction for the expense without having to pay additional employment taxes.

- **SEP IRA.** These plans are funded by employer contributions only and as such, tend to work well for small businesses with only a few key employees. SEP IRAs can be established and funded anytime up to the filing deadline (including extensions),. As such, a business can establish and fund a plan in 2021, yet take advantage of the deduction on the 2020 return. Contributions are limited to the lessor of 25% of each eligible employees compensation or $57,000.

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- **SIMPLE IRA.** These plans are funded by a combination of employee deferrals and employer contributions. Employees are eligible to defer up to $13,500 (plus an additional $3,000 if over age 50). Employers are generally required to make contributions to the account whether or not the employee elects to make deferrals. Additionally, a SIMPLE IRA must be established prior to October 1 of the current tax year in order to receive deductible contributions. Employee deferrals must be made by December 31. Employer contributions must be funded by April 15, 2021 to be deductible on the 2020 return.

Contribute to or Establish a Profit Sharing Plan

Profit sharing plans are a type of defined contributions plans that allow a company to help its employees save for retirement while providing significant flexibility for the employer in terms of contribution requirements. Similar to a SEP IRA, contributions are funded by the employer only. However, annual contributions are not mandatory and the employer has some flexibility in setting participation eligibility. For more information about these plans see our whitepapers at www.dh-cpa.com.

The Research & Development (R&D) Tax Credit

Historically, the benefits of the R&D tax credit have had little or no benefits for business owners. However, as a result of changes in the tax law, businesses are finally able to benefit from this business credit. In fact, federal and state tax credits can amount to as much as 20% of the costs incurred in developing new products and/or manufacturing processes, or improving existing products and processes. You can go back 3 years to claim past credits and carry forward credits for up to 20 years. The newly enhanced benefits of the R&D credit make it worthwhile for applicable businesses to look closely at the requirements. To view the white paper click here.

Solar Investment Tax Credit

For 2020, federal law allows a 26 percent tax credit for solar systems on residential and commercial properties. The credit is reduced to 22% for projects that commence construction in 2021. If your business solar project is eligible and receives the federal tax credit you can also receive the Vermont tax credit. The current credit amount is 24% of the investment tax credit attributable to the Vermont-property portion of the investment.

Understand how PPP Loans and related forgiveness will be taxed.

The CARES Act created the Paycheck Protection Program which authorized small business loans to cover employee salaries and certain other expenses in the height of the COVID-19 crisis. Businesses that received funds may qualify for full or partial loan forgiveness if certain qualifications are met and the required forgiveness application is completed and approved. PPP loan amounts subsequently forgiven will not be subject to tax. However, the IRS has stated that expenses used in the calculation of PPP loan forgiveness are nondeductible, essentially reversing the tax-free benefit of the loan exclusion. Expenses used in the calculation of PPP forgiveness are excluded from the expenses used to determine net income for tax purposes, thus increasing profit and thereby increasing taxes.

Conclusion. This newsletter is intended to give you just a few ideas to get you thinking about planning for 2020**.** Copper Leaf Financial develops a customized wealth management (financial) plan designed to integrate every aspect of your financial life. This is "true wealth management" - a holistic approach that goes beyond just investment advice. Our affiliated full service CPA firm, Davis & Hodgdon Associates, enables us to tightly integrate individual and business owner's wealth management with comprehensive tax advice so that all recommendations can factor in the tax consequences.

Call us today at (802) 878-2731 to schedule a strategy session and begin building your road map to financial success.