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2020 YEAR-END INCOME TAX PLANNING FOR BUSINESSES- SUMMARY VERSION

INTRODUCTION

WOW – what a crazy year! We are sure that you’re looking forward to 2021 as much as we are. Despite all of the difficulty that the Pandemic has caused all of us, one positive to come out of it was relatively few changes to our income tax laws. Those laws that were passed were almost exclusively related to the Pandemic.

INTRODUCTION

It’s that time of year when businesses normally start developing year-end planning strategies. However, there has never been a year quite like 2020. We think it is safe to say that year-end tax planning for 2020 is proving to be the trickiest in recent memory. In response to the Coronavirus, Congress and the IRS have been exceedingly busy enacting and issuing never-seen-before tax relief for businesses and employers. Congress had little choice but to pass this complex legislation quickly, without time for adequate review. Consequently, as one would expect, there continues to be significant uncertainty on the application and implementation of many of the most important provisions in this legislation. In addition, Congress may not be through as it continues to struggle with attempts to enact even more Coronavirus relief legislation before the end of the year. Moreover, for well over a decade, we have been faced with the off-and-on expiration of a long list of popular business tax breaks. Historically, Congress has temporarily extended the majority of these tax breaks every few years. Unfortunately, several of these traditional tax breaks are currently scheduled to expire after the end of 2020.

We are sending this letter to help bring you up-to-date on the most significant tax provisions that could impact year-end planning for businesses. We start this letter with a listing of selected historic business tax breaks scheduled to expire at the end of 2020. We then discuss selected COVID-related tax provisions that are most likely to impact businesses. We conclude this letter by highlighting certain time-honored, year-end tax planning techniques many businesses should consider notwithstanding the uncertain times we are currently experiencing.

Caution! It is entirely possible that Congress could enact additional COVID-related tax legislation before the end of this year. In addition, the IRS continues releasing guidance on various important tax provisions (particularly on COVID-related tax provisions that have already been enacted).

Be careful! Although this letter contains planning ideas, you cannot properly evaluate a particular planning strategy without calculating the overall tax liability for the business and its owners (including the alternative minimum tax) with and without the strategy. In addition, this letter contains ideas for Federal income tax planning only. **State income tax issues are not addressed.** However, you should consider the state income tax impact of a particular planning strategy. We recommend that **you call our Firm before implementing any tax planning technique** discussed in this letter, **or if you need more information concerning anything discussed.**

On a much brighter note, now that 2020 is pretty much toast, let’s get to know the team and how we feel about our own toast! Catch all four tidbits about our crew and win a treat!!

2020 MAY BE OUR LAST CHANCE TO TAKE ADVANTAGE OF THESE TRADITIONAL BUSINESS TAX BREAKS

For well over a decade, we have been faced with the off-and-on expiration of a long list of popular tax breaks for businesses. Historically, Congress has temporarily extended the majority of these tax breaks every few years. However, several of these tax breaks for businesses **are scheduled to expire at the end of 2020**, and Congress has yet to extend them. Some of the more popular business tax breaks scheduled to expire at the **end of 2020** include: Deductions for qualified improvements to certain energy-efficient commercial buildings; Credit of up to \$2,000 for construction of qualified energy-efficient new homes; 7-year depreciation period for certain motor sports racetrack property; Employer credit for payments for qualified family and medical leave; 3-year depreciation period for certain race horses; and the Work Opportunity Credit for hiring workers from certain disadvantaged groups. **Please note** as we send this letter, it has been reported that some members of Congress are still pushing for these tax breaks to be extended beyond 2020. However, only time will tell whether they will be extended. **Planning Alert!** In addition to these traditional expiring tax breaks, the COVID-inspired CARES Act (discussed in more detail below) also contains certain tax breaks scheduled to expire after 2020. For example, the 50% employee retention credit of up to \$5,000 per employee is effective for qualified wages paid after March 12, 2020 and **before January 1, 2021**. **Caution!** Although not expiring, the current 26% business tax credit for **Qualified Solar Energy Property, Fiber-Optic Solar Property, Qualified Fuel Cell Property and Qualified Small Wind Energy Property** is **reduced to 22%** for qualified property where the construction of the property **begins after 2020 and before 2022**. Thus, to qualify for the full **26% credit (instead of next year's 22% credit)**, construction of the qualifying energy-efficient property must begin no later than **December 31, 2020**.

HIGHLIGHTS OF SELECTED COVID-RELATED TAX PROVISIONS IMPACTING BUSINESSES

Largely in response to government-mandated shutdowns caused by COVID-19 (COVID), Congress enacted a series of tax-relief measures for businesses, including: The **Families First Coronavirus Response Act ("Families First Act")** and the **Coronavirus Aid, Relief and Economic Security Act ("CARES Act")**. It is well beyond the scope of this letter to provide you a detailed discussion of the many business tax relief provisions contained in this voluminous legislation. Instead, the following are *selected* highlights that could have an impact on your business tax planning. **Caution!** Congress passed most of this recent COVID-Related legislation in a hurried fashion, without time to address the many uncertainties that would inevitably arise. As a result, over the last several months, we have experienced a stream of piecemeal guidance from the IRS and Small Business Administration (SBA) attempting to respond to some of these uncertainties. As we finish this letter, we are still waiting for guidance on many unanswered questions. Our firm continues to monitor the developments in this area, so please call our firm if you need additional information regarding any of the provisions listed below.

Paycheck Protection Program Loans (PPP Loans). This program was intended to provide struggling businesses with a quick infusion of cash to stay afloat and to retain employees in the midst of government-mandated shutdowns. The initial cash outlay was in the form of a PPP Loan, with a potential for all or a portion of the loan to be forgiven if the borrower could establish that the borrowed funds were used for certain qualifying business expenditures (i.e., generally payroll, rent, utilities, and mortgage payments) during a designated 8-week or 24-week "Covered Period." As we send this letter, the PPP Loan program stopped accepting loan applications on August 8, 2020 (although there are legislative proposals to extend that deadline). The SBA reported that there have been more than 5.2 million PPP Loans made aggregating approximately \$525 billion in total. **Planning Alert!** Most PPP Loan borrowers are now struggling with how and when they should apply to the lender for their PPP Loan forgiveness. There are continued uncertainties regarding the PPP Loan forgiveness process, and we are hoping for additional guidance in the near future. As we wait for that guidance, here are a few things you should know:

- **No Defined Deadline For Submitting PPP Loan Forgiveness Application.** There is currently no deadline for submitting a PPP Loan Forgiveness Application. Generally, payments (if any) are not due on a PPP Loan until the SBA

remits the PPP Loan's forgiveness amount (if any) to the initial lender of the PPP Loan. However, if the borrower fails to apply for loan forgiveness within 10 months of the end of the borrower's 8-week or 24-week covered period, payments of principal and interest on the PPP Loan must begin at the end of that 10-month period.

- **Deductibility Of Expenses Related To The PPP Loan Forgiveness Amount.** Even though the CARES Act provides that forgiveness of a PPP Loan is tax free, the IRS is currently taking the position that no tax deduction will be allowed for an expense, if the payment of that expense results in the forgiveness of a PPP Loan amount. As we complete this letter, there is significant pressure from business and professional groups urging the IRS to allow such deductions, or for Congress to pass legislation that would allow the deductions. Please contact our firm if you want a status report on this issue. **(For Joan, jelly belongs on a PBJ sandwich, NOT on toast. She's a Benecol girl!)**
- **Expedited Forgiveness Procedures For Smaller PPP Loans.** The procedures for gathering documentation and applying for PPP Loan forgiveness could be tedious and time consuming. **Planning Alert!** In early October, the IRS and the SBA released a new "simplified" PPP Loan forgiveness Application Form that can be used only by borrowers that **received a PPP Loan of \$50,000 or less.** This should significantly simplify the PPP Loan Forgiveness process for those qualifying borrowers who borrowed \$50,000 or less. **Caution!** Certain members of Congress are currently promoting legislation that, if passed, could also substantially streamline the loan forgiveness process for PPP Loans under a certain dollar threshold that could turn out to be higher than \$50,000. As we complete this letter, the chance of this type of legislation being enacted is uncertain.

Employment-Related Payroll Tax Credits, Deferrals, Etc. Last Spring, in addition to the PPP Loan provision, Congress passed a dizzying array of tax relief provisions designed to subsidize qualifying employers for keeping employees on their payroll, and to provide additional liquidity for their businesses. These tax relief provisions include: Refundable employer tax credits of up to 100% of the qualifying Sick Leave And Family Leave Payments made to qualifying employees; Refundable income tax credits for self-employed individuals with respect to their "Family Leave and Sick Leave Equivalent Amounts;" Refundable 50% Employee Retention Credit for qualifying wages paid by certain employers experiencing business closure or economic hardship due to COVID; and, Deferral of deposits for the 6.2% portion of employer payroll taxes (can also apply to the 6.2% portion of S/E Tax). **Planning Alert!** It is well beyond the scope of this letter to provide a detailed discussion of the various technical requirements a business must satisfy to qualify for and claim these benefits. However, if you think your business may qualify for any of these tax benefits, feel free to call our firm. We will be glad to review your particular situation and advise you whether your business qualifies.

Temporary Relief For Net Operating Losses (NOLs). Before the Tax Cuts And Jobs Act of 2017 (TCJA), net operating losses (NOLs) could generally be carried back two prior years, and carried forward for 20 years. TCJA generally repealed the 2-year carried back period for NOLs (except for NOLs attributable to certain farming businesses and certain property and casualty insurance companies), and allowed NOLs to be carried forward indefinitely. TCJA also limited the deduction for NOL carryforwards to 80% of the taxable income for the carryover year. The CARES Act generally provides the following temporary relief with respect to NOLs: **1)** Allows NOLs arising in tax years beginning after 2017 and before 2021 (e.g., NOLs arising in calendar years 2018, 2019, or 2020 for calendar-year taxpayers) to be carried back to 5 preceding years; and **2)** Removes the 80% of taxable income limit for the NOL deduction for any tax year beginning before 2021. **Planning Alert!** A taxpayer may elect to forego the carryback of an NOL. Generally, the election to forego the NOL carryback must be made by the due date (including extensions) for the year of the NOL. The CARES Act provides that the election to forego the 5-year NOL carryback for tax years beginning in 2018 or 2019, may be made by the due date (including extensions) of the taxpayer's return for the first taxable year ending after March 27, 2020.

Temporary Increase Of Limit On Business Interest Expense From 30% To 50% Of ATI. Effective for tax years beginning after 2017, TCJA generally limited the amount of business interest expense in excess of business interest income allowed as a deduction to 30% of Adjusted Taxable Income (ATI). Businesses with average gross receipts for the preceding three years of \$25 million (\$26 million for 2020) or less are generally exempt from this limit. The CARES Act makes the following changes: **1)** Increases the limit from 30% to 50% of ATI (unless the taxpayer elects otherwise) for tax years beginning in 2019 and 2020; **2)** Allows a taxpayer to use its "2019" ATI for purposes of determining the amount of the

50% of ATI limit for “2020”; **3)** For partnerships, the 30% of ATI limit remains in place for 2019 but is 50% for 2020; and **4)** Unless a partner elects otherwise, 50% of a partnership’s “excess business interest” allocated to a partner in 2019 is fully deductible by the partner in 2020 and not subject to the 50% ATI limitation (the remaining 50% of excess business interest from 2019 allocated to the partner is subject to the regular ATI limitations for 2020 and subsequent years).

Retroactive Fix For Computing Depreciation For “Qualified Improvement Property.” The CARES Act finally corrected the depreciation “glitch” contained in TCJA with respect to “Qualified Improvement Property.” **Qualified Improvement Property (QIP)** is generally defined as *“an improvement”* to the *interior portion* of a *commercial building* (provided the improvement is not attributable to an enlargement of the building, elevators or escalators, or the internal structural framework of the building), if the improvement is placed in service *“after”* the building was first placed in service. Due to a drafting error in TCJA, QIP was assigned a depreciable life of 39 years, instead of the intended 15 year life. To compound the error, assigning QIP a depreciable life of 39 years (instead of 15 years) also disqualified QIP for the 100% 168(k) first-year bonus depreciation, because 168(k) property must have a depreciable life of 20 years or less. The CARES Act fixes this mistake retroactively by assigning a 15-year depreciable life for all QIP that was **placed in service after 2017**. Therefore, QIP placed in service in 2018 or 2019 retroactively qualifies for the 100% 168(k) bonus depreciation. **Tax Tip!** This is great news for taxpayers that have previously capitalized post-2017 remodeling costs for existing restaurants, retail stores, and office buildings. So long as the qualifying improvements to the remodeled property was placed in service after 2017, the capitalized remodeling should now qualify for a 100% write off under 168(k). **Planning Alert!** Recently-issued final 168(k) regulations confirm that a purchaser of an existing commercial building containing QIP made by a previous owner, will not be able to treat any portion of the building’s purchase price as QIP.

- **Claiming The 100% 168(k) Depreciation For QIP Placed In Service In 2018 Or 2019.** The IRS says that we generally have two options to recoup the unclaimed 100% depreciation deduction for QIP placed in service in 2018 or 2019. **First**, we can amend the 2018 or 2019 return and claim the 100% depreciation deduction on the amended return. If we choose to amend the 2018 return, the IRS says that we must file the amended 2018 return **no later than October 15, 2021**. **Second**, we could recoup the 100% 168(k) depreciation by claiming it through an automatic accounting method change in a subsequent year. For example, by filing an automatic accounting method change, you could claim the 100% deduction on your 2020 return (or even a later return). **Planning Alert!** If the QIP was placed in service in 2018 or 2019 by a partnership subject to the Centralized Partnership Audit Regime, our options for recouping the 100% depreciation deduction are more limited. We can either: **1)** File for an “Administrative Adjustment Request” (AAR) under the new “Centralized Partnership Audit Regime” for the current tax year, or **2)** File for an automatic accounting method change. **(Jenelle would prefer her toast with eggs, sunny side up, thank you very much!)**

SELECTED TAX CHANGES INCLUDED IN OTHER RECENT LEGISLATION

Recent Legislation Extends The Due Date For Establishing A New Retirement Plan. Before the passage of the Consolidated Appropriations Act of 2020 (the “Appropriations Act”), calendar-year taxpayers wishing to establish a new qualified retirement plan for a tax year generally had to adopt the plan by December 31st of that year. However, a SEP could be established by the due date of the tax return (including extensions), but a **SIMPLE plan** was required to be established by October 1st of that year. **Effective for plans adopted for taxable years beginning after 2019**, the Appropriations Act generally allows the adoption of a stock bonus, pension, profit-sharing, or annuity plan for a taxable year after the close of the taxable year as long as the plan is adopted by the due date of the employer’s tax return, including extensions. **Caution!** The IRS says that a SIMPLE plan must still be adopted for an existing business with an effective date no later than October 1st of the year. Moreover, the Committee Reports to the Act say this new extended adoption date does not override rules requiring certain plan provisions to be in effect during a plan year, such as the provision for elective deferrals under a qualified cash or deferral arrangement (also known as a 401(k) plan).

Retroactive Repeal UBIT Imposed On Tax-Exempt Organizations That Provide Employee Parking. Under the Tax Cuts and Jobs Act (TCJA), a tax-exempt organization’s unrelated business taxable income was increased by amounts paid or incurred by the organization to provide employee parking. This provision was effective for amounts paid or incurred

after 2017. Recent legislation repealed this provision retroactively, effective for **amounts paid or incurred after 2017**. **Planning Alert!** Tax-exempt organizations that previously paid unrelated business income tax on expenses for qualified transportation fringe benefits, including employee parking, may now claim a refund. To do so, they should file an amended Form 990-T within the time allowed for refunds. More information on this process can be found at “*How To Claim a Refund or Credit of Unrelated Business Income Tax (UBIT) or adjust Form 990-T for Qualified Transportation Fringe Amounts*” at the IRS website.

Don't Overlook Simplified Accounting Methods For Certain Small Businesses. Although not part of the recent COVID-related tax legislation, it's important to be aware that the Tax Cuts And Jobs Act (enacted in late 2017) provides for the following accounting method relief for businesses with **Average Gross Receipts (AGRs) for the Preceding Three Tax Years of \$26 Million or Less for 2020:** **1)** Generally allows businesses to use the cash method of accounting even if the business has inventories, **2)** Allows simplified methods for accounting for inventories, **3)** Exempts businesses from applying UNICAP, and **4)** Liberalizes the availability of the completed-contract method. **Planning Alert!** The IRS has released detailed procedures to follow for taxpayers who qualify and wish to change their accounting methods in light of these new relief provisions. Please call our firm if you want us to help you determine whether any of these simplified accounting methods might be available to your business.

TRADITIONAL YEAR-END TAX PLANNING TECHNIQUES

Pay Special Attention to “Timing” Issues! From a tax-planning standpoint, 2020 has been anything but a “normal” year for many businesses. The coronavirus has caused many businesses to incur an unprecedented loss of revenues during 2020, combined with unexpected additional costs. While at the same time, some business sectors have actually flourished during this difficult time. Consequently, for 2020, there is clearly no single year-end tax planning strategy that will necessarily apply to all (or even a majority) of businesses. **Planning Alert!** In normal times, a traditional year-end tax planning strategy for businesses would include reducing current year taxable income by deferring taxable income into later years and accelerating deductions into the current year. This strategy has been particularly beneficial where the income tax rate on the business's income in the following year is expected to be the same or lower than the current year. For businesses that have done well during the COVID crisis, this strategy would still generally be advisable. However, for businesses that expect their taxable income to be much lower in 2020 than in 2021, the opposite strategy might be more advisable. **Caution!** As we discuss the planning methods that involve the “timing” of income or deductions, please keep in mind that you might want to consider taking the precise opposite steps recommended, if you decide it would be better to defer deductions into 2021, while accelerating income into 2020. Moreover, the relatively new 20% 199A deduction that was first available in 2018 adds another wrinkle to deciding whether to defer or accelerate revenues, and/or to defer or accelerate deductions. As discussed in more detail below, your ability to take maximum advantage of the 20% 199A deduction for 2020 and/or 2021 may, in certain situations, be enhanced significantly if you are able to keep your taxable income below certain thresholds. Consequently, please keep that factor in mind as you read through the following timing strategies for income and deductions.

Planning With The First-Year 168(k) Bonus Depreciation Deduction. Traditionally, a popular way for businesses to maximize current-year deductions has been to take advantage of the **First-Year 168(k) Bonus Depreciation Deduction**. Before the “*Tax Cuts And Jobs Act*” (TCJA) which was enacted in late 2017, the 168(k) Bonus Depreciation deduction was equal to 50% of the cost of qualifying “**new**” depreciable assets placed in service. TCJA temporarily increased the 168(k) Bonus Depreciation deduction **to 100%** for qualifying property acquired and placed in service **after September 27, 2017** and **before January 1, 2023**. TCJA further enhanced the 168(k) Bonus Depreciation deduction by making the following changes: **(Sallie wants her toast very well done, please!)**

- **“Used” Property Temporarily Qualifies For 168(k) Bonus Depreciation.** Before TCJA, only “**new**” qualifying property was eligible for the 168(k) Bonus Depreciation deduction. For qualifying property acquired and placed in service **after September 27, 2017 and before 2027**, the 168(k) Bonus Depreciation may be taken on “**new**” or “**used**” property. Therefore, property that generally qualifies for the 168(k) Bonus Depreciation includes “**new**” or “**used**” business property that has a depreciable life for tax purposes of **20 years or less** (e.g., machinery and equipment,

furniture and fixtures, sidewalks, roads, landscaping, computers, computer software, farm buildings, and qualified motor fuels facilities). **Caution!** As discussed previously, a purchaser of an existing commercial building containing QIP made by a previous owner, will not be able to treat any portion of the building's purchase price as QIP. **Planning Alert!** The expansion of the 168(k) Bonus Depreciation to "used" property has expanded planning opportunities, including: **1)** A lessee that currently leases qualifying 168(k) property (e.g., leased equipment) from an unrelated lessor, could later purchase the property from the lessor and qualify for the 100% 168(k) Bonus Depreciation; **2)** Taxpayers that purchase the operating assets of another operating business will be able to deduct 100% of the purchase price that is properly allocated to 168(k) assets (other than QIP) of the target business; and **3)** The IRS says that a person who buys a partnership interest from an unrelated selling partner may be entitled to the 100% 168(k) Bonus Depreciation deduction with respect to a certain portion of the purchase price of the partnership interest, if the partnership owns existing qualifying 168(k) property.

- **The 100% 168(k) Bonus Depreciation Deduction For "Used" Property Generally Makes Cost Segregation Studies More Valuable.** Depreciable components of a building that are properly classified as depreciable personal property under a **cost segregation study** are generally depreciated over 5 to 7 years. **Before TCJA**, these depreciable building components for a purchaser of a "used" building generally qualified for the 179 Deduction (subject to the dollar caps), but did not qualify for a 168(k) Bonus Depreciation deduction because the 168(k) depreciation deduction only applied to "new" property. However, after TCJA, the depreciable components of a building that are properly classified as "personal property" (as opposed to "real property") will qualify for the 100% 168(k) Bonus Depreciation (whether new or used).
- **Annual Depreciation Caps For Passenger Vehicles Increased.** Vehicles used primarily in business generally qualify for the 168(k) Bonus Depreciation. However, there is a dollar cap imposed on business cars, and also on trucks, vans, and SUVs that have a **loaded vehicle weight of 6,000 lbs or less**. This dollar cap was increased significantly under TCJA. More specifically, for qualifying vehicles placed in service **in 2020** and used 100% for business, the annual depreciation caps are as follows: **1st year - \$10,100; 2nd year - \$16,100; 3rd year - \$9,700; fourth and subsequent years - \$5,760**. Moreover, if the vehicle (new or used) otherwise qualifies for the 168(k) Bonus Depreciation, the first year depreciation cap (assuming 100% business use) is increased by \$8,000 (i.e., from \$10,100 to \$18,100 for 2020). Thus, a vehicle otherwise qualifying for the 168(k) Bonus Depreciation deduction with loaded **Gross Vehicle Weight (GVW) of 6,000 lbs or less used exclusively for business and placed in service in 2020** would be entitled to a **depreciation deduction for 2020 of up to \$18,100**, whether purchased new or used. If the vehicle continues to be used exclusively for business during the **second year** (i.e., during 2021), it would be entitled to a second-year depreciation deduction of **up to \$16,100**. **Planning Alert!** Even better, if the same new or used business vehicle (which is used 100% for business) has a loaded GVW **over 6,000 lbs, 100% of its cost** (without a dollar cap) could be deducted **in 2020** as a **168(k) Bonus Depreciation deduction**. **Caution!** When taking the 168(k) Bonus Depreciation on your business vehicle (and whether or not it weighs more than 6,000 lbs), if your business-use percentage **drops to 50% or below** in a later year, you will generally be required to bring into income a portion of the deduction taken in the first year.
- **168(k) Bonus Depreciation Taken In Tax Year Qualifying Property Is "Placed In Service."** The 168(k) Bonus Depreciation deduction is taken in the tax year the qualifying property is "placed in service." Consequently, if your business anticipates acquiring qualifying 168(k) property between now and the end of the year, the 168(k) Bonus Depreciation deduction is taken in 2020 if the property is placed in service **no later than December 31, 2020**. Alternatively, the 168(k) Bonus Depreciation deduction can be deferred until 2021 if the qualifying property is placed in service in 2021. Generally, if you are purchasing "personal property" (equipment, computer, vehicles, etc.), "placed in service" means the property is **ready and available** for use (this commonly means the date on which the property has been **set up and tested**). If you are dealing with building improvements (e.g., "Qualified Improvement Property"), the date on the **Certificate of Occupancy** is commonly considered the date the qualifying building improvements are placed in service.

Un-Reimbursed Employee Business Expenses Are Not Deductible! For 2018 through 2025, "un-reimbursed" employee

business expenses are not deductible at all by an employee. **Good News!** Generally, employee business expenses that are reimbursed under an employer's qualified "**Accountable Reimbursement Arrangement**" are deductible by the employer (subject to the 50% limit on business meals), and the reimbursements are **not taxable to the employee**. However, reimbursements under an arrangement that is not a qualified "Accountable Reimbursement Arrangement" generally must be treated as compensation and included in the employee's W-2, and the employer would get no offsetting deduction for the business expense. **Planning Alert!** Generally, for a reimbursement arrangement to qualify as an "**Accountable Reimbursement Arrangement**" - **1)** The employer must maintain a reimbursement arrangement that requires the employee to substantiate covered expenses, **2)** The reimbursement arrangement must require the return of amounts paid to the employee that are in excess of the amounts substantiated, and **3)** There must be a business connection between the reimbursement (or advance) and anticipated business expenses. **(Alex loves cheese and makes a mean toasted sandwich with aged gouda, crumbled bacon and Granny Smith apples!)**

Restrictions On Deducting Entertainment Expenses. Generally, business expenditures with respect to an entertainment, amusement or recreation activity are not deductible after 2017. **Planning Alert!** Fortunately, the IRS has announced that taxpayers can still generally deduct 50% of the cost of meals with a business associate (e.g., a current or potential business customer, client, supplier, employee, agent, partner, professional advisor). In addition, the IRS stated that a taxpayer could deduct 50% of the cost of food and beverages provided during a nondeductible entertainment activity with a business associate provided the food and beverages are purchased separately from the entertainment, or the cost of the food and beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts. **Caution!** If an employer reimburses an employee's deductible business meal and beverage expense under an Accountable Reimbursement Arrangement, the employer could deduct 50% of the reimbursement. However, as discussed previously, an employee who is not reimbursed by the employer for the business meal would get no deduction because un-reimbursed employee business expenses are not deductible (from 2018 through 2025).

S Corporation Shareholders Should Check Stock And Debt Basis Before Year-End. If you own S corporation stock and you think your S corporation will have a tax loss this year, you should contact us as soon as possible. These losses will not be deductible on your personal return unless and until you have adequate "basis" in your S corporation. Any pass-through loss that exceeds your "basis" in the S corporation will carry over to succeeding years. You have basis to the extent of the amounts paid for your stock (adjusted for net pass-through income, losses, and distributions), **plus** any amounts you have personally loaned to your S corporation. **Caution!** A shareholder cannot get debt basis by merely guaranteeing a third-party loan to the S corporation. **Please do not attempt to restructure your loans without contacting us first.**

Deductions For Business Expenses Paid By Partners May Be Limited. Historically, the IRS has ruled that a partner may deduct business expenses **paid on behalf** of the partnership **only if** there is an agreement (preferably in writing) between the partner and the partnership providing that those expenses are to be paid by the partner, and that the expenses will not be reimbursed by the partnership. **Tax Tip.** If you are a partner paying unreimbursed expenses on behalf of your partnership, to be safe, you should have a written agreement with the partnership providing that those expenses are to be paid by you, and that the expenses will not be reimbursed by the partnership.

Maximize Your 20% 199A Deduction For "Qualified Business Income" (QBI). First effective in 2018, the 20% 199A Deduction has had a major impact on businesses. This provision allows qualified taxpayers to take a 20% Deduction with respect to "**Qualified Business Income,**" "**Qualified REIT Dividends,**" and "**Publicly-Traded Partnership Income.**" Based on 2018 and 2019 tax filings, of these three types of qualifying income, "**Qualified Business Income**" (QBI) has had the biggest impact by far on the greatest number of taxpayers. Consequently, this discussion of the 20% 199A Deduction focuses **primarily on "Qualified Business Income" (QBI).** **Planning Alert!** As many of you discovered with your 2018 and 2019 returns, if you own an interest in a business as a sole proprietor, an S corporation shareholder, or a partner in a partnership, you are a very good candidate for the 20% 199A Deduction with respect to QBI. Unfortunately, it is not feasible to provide a thorough discussion of the 20% 199A Deduction for **Qualified Business Income (QBI)** in this letter. However, the following are selected highlights that could be particularly helpful for year-end planning:

- **W-2 Wage And Capital Limitation On The Amount Of The 20% Of QBI Deduction.** Generally, the amount of your 20% of QBI Deduction with respect to each Qualified Trade or Business may not exceed **the greater of: 1)** 50% of the allocable share of the business's W-2 wages allocated to the QBI of each "Qualified Trade or Business," or **2)** The sum of 25% of your allocable share of W-2 wages with respect to each "Qualified Trade or Business," plus 2.5% of your allocable share of unadjusted basis of tangible depreciable property held by the business at the close of the taxable year. **Planning Alert!** For 2020, an otherwise qualifying taxpayer is **entirely exempt** from the **W-2 Wage And Capital Limitation** if the Taxpayer's "**Taxable Income**" (computed without regard to the 20% 199A Deduction) is **\$163,300 or below (\$326,600 or below if married filing jointly)**. **Caution!** For 2020, the Wage and Capital Limitation phases in ratably as a taxpayer's Taxable Income **goes from more than \$163,300 to \$213,300, or from more than \$326,600 to \$426,600** (if filing jointly).
- **Business Income From "Specified Service Trade Or Businesses" (SSTBs) Does Not Qualify For The 20% 199A Deduction For Owners Who Have "Taxable Income" Above Certain Thresholds.** Based on your "Taxable Income" (before the 20% 199A Deduction), all or a portion of your qualified business income from a so-called "Specified Service Trade or Business" (i.e., certain service-type operations in various professional fields such as law, medicine, accounting, consulting, etc.) **may not qualify** for the 20% 199A Deduction. More specifically, if your "**Taxable Income**" for 2020 (before the 20% 199A Deduction) is **\$163,300 or below (\$326,600 or below if married filing jointly)**, "**all**" of the qualified business income from your "Specified Service Trade or Business" (SSTB) is eligible for the 20% 199A deduction. However, if for 2020 your "**Taxable Income**" is **\$213,300 or more (\$426,600 or more if married filing jointly)**, "**none**" of your SSTB income qualifies for the 20% 199A Deduction. **Caution!** If for 2020, your "**Taxable Income**" is **between \$163,300 and \$213,300 (between \$326,600 and \$426,600 if married filing jointly)**, only "**a portion**" of your SSTB income will be eligible for the 20% 199A Deduction.
- **Planning Alert!** A taxpayer with Taxable Income for 2020 of **\$163,300 or less (\$326,600 or less if married filing jointly)** qualifies for two major benefits: **1)** The taxpayer's SSTB income (if any) is fully eligible for the 20% 199A deduction, **and 2)** The taxpayer is completely exempt from the W-2 Wage and Capital Limitation. Consequently, if you are in a situation where your 20% 199A Deduction would otherwise be significantly reduced (or even eliminated altogether) due to either or both of these limitations, it is even more important that you consider year-end strategies that could help you reduce your 2020 taxable income (before the 20% 199A Deduction) to or below the \$163,300/\$326,600 thresholds.
- **Evaluating Reasonable W-2 Compensation Levels Paid To S Corp Owners/Employees Is More Important Than Ever!** Even before the 20% 199A Deduction provision was enacted, S corporation shareholder/employees have had an incentive to pay themselves W-2 wages as low as possible because only the shareholder's W-2 income from the S corporation is subject to FICA taxes. Other income of the shareholder from the S corporation is generally not subject to FICA or Self-Employment (S/E) taxes. Traditionally, where the IRS has determined that an S corporation shareholder/employee has taken unreasonably "**low**" compensation from the S corporation, the IRS has argued that other amounts the shareholder has received from the S corporation (e.g., distributions) are disguised "**compensation**" and should be subject to FICA taxes. In light of the 20% 199A Deduction, reviewing the W-2 wage level for Shareholder/Employees of S Corporations becomes even more important. **For example**, for S Corporation shareholder/employees who expect to have 2020 Taxable Income (before the 20% 199A Deduction) of **\$163,300 or less (\$326,600 or less if married filing jointly)**, in order to maximize their potential 20% 199A Deduction **there is a tax incentive** to keep the shareholders' **W-2 wages as "low" as possible**, because: **1)** The W-2 Wages paid to shareholders **do not qualify** for the 20% 199A Deduction, but the W-2 Wages **do reduce** a shareholder's pass-through Qualified Business Income, **2)** The shareholder will be exempt from the W-2 Wage and Capital Limitation (so lower W-2 wages will not limit the shareholder's potential 20% 199A Deduction amount), and **3)** The shareholder's pass-through SSTB income (if any) will be fully eligible for the 20% 199A Deduction, while W-2 wages paid to the shareholder/employee will not qualify. **Caution!** The IRS has a long history of attacking S Corporations that it believes are paying shareholder/employees unreasonably low W-2 wages. **Planning Alert!** If you want our Firm to review the W-2 wages that your S corporation is currently paying to its shareholders in light of this 20% 199A

Deduction, please contact us as soon as possible. The quicker you contact us on this issue, the better chance you have to take steps before the end of 2020 to increase your 20% deduction.

FINAL COMMENTS

We thank you once again for your friendship, business and referrals...

Without you, we would not be here. It is an honor to work with all of our clients. The growth of our firm has come mostly from referrals, and we remain grateful for your trust and confidence. We will continue to do everything within our power to validate your feelings and confidence in our abilities.

We look forward to seeing everyone during the coming tax season, and we want you to know that we truly do appreciate the trust you put in us to help you with your tax and business needs. We wish you and yours the happiest and healthiest holiday season and 2021.

For those that came here first, looking for clues – good for you! If you’re one of the first 30 people to make it through the whole newsletter and let us know something about each member of our team, you’ll get a treat.

From all of us here at Alexandra L. Miller, CPA, P.C.

THANK YOU!

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our Firm closely monitors these changes. In addition, **please call us before implementing any planning idea discussed in this letter, or if you need additional information concerning any item mentioned in this letter.** We will gladly assist you. **Note!** The information contained in this material should not be relied upon without an independent, professional analysis of how any of the items discussed may apply to a specific situation.

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