Greetings,

In the last few months of the year, it is important to consider year-end tax planning opportunities, as many may provide both immediate and long-lasting financial benefits.

This year has brought unique challenges and significant change. Businesses that have not yet explored year-end tax planning should take an immediate inventory of their situation to ensure they are sufficiently informed and well-positioned to minimize current and future tax burdens. Whether it be refining past plans, developing new ones, or a combination of both, our office is ready to assist you.

We have compiled a checklist of additional actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all actions will apply to your situation, but you may likely benefit from some of them. We can narrow down the specific actions you can take once we meet with you to tailor a customized plan. In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves to make.

Download the following letter here

Federal

- Bonus Depreciation and Code Section 179 Expensing
  Among the top two incentives for small businesses are bonus depreciation and the Code Sec. 179 small business expensing provision. These two provisions were greatly expanded with the Tax Cut and Jobs Act of 2017. Bonus depreciation continues as 100% for property placed in service in 2020. Both used equipment and new equipment qualify. The Section 179 deduction limit increased to $1,040,000 for 2020 from $1,020,000 in 2019. These two incentives can provide significant tax relief in 2020 if financed and placed in service by midnight, December 31, 2020.

  Additionally, the Coronavirus Aid, Relief, and Economic Security (CARES) Act assigned a 15-year recovery period to Qualified Improvement Property (QIP), which previously had been required to be depreciated over 39 years under the Tax Cuts and Jobs Act. This modification means that QIP is now eligible for bonus depreciation at 100% and is effective for QIP placed into service after December 31, 2017. Qualified Improvement Property includes improvements made to an interior portion of an existing residential or nonresidential building.

- Repair Capitalization Rules

  Another valuable incentive for year-end planning is the de minimis safe harbor threshold amount under the final "repair regs" for taxpayers. Currently, a de minimis safe harbor under the repair regs allows taxpayers to deduct certain items costing $5,000 or less (per item or invoice) and that are deductible in accordance with the company's accounting policy reflected on their applicable financial statement (AFS). IRS regulations also provide a $2,500 de minimis safe harbor threshold for taxpayers without an applicable financial statement.

- Research Tax Credit ("R&D Tax Credit")

  The Protecting Americans from Tax Hikes Act of 2015 made the R&D credit permanent. In addition to credit permanency, the legislation also expanded the research credit, making it a much more effective tax planning tool for small and mid-sized businesses. Eligible taxpayers with an average of $50 million or less in gross receipts over the previous three years may claim the federal R&D tax credit against their alternative minimum tax liability. The PATH Act also allows startup businesses with no federal tax liability and gross receipts of less than $5 million to take the R&D tax credit against their payroll taxes for tax years beginning after December 31, 2015, essentially making it a refundable credit capped at $250,000 for up to five years.

  Some common industries that qualify for the R&D tax credit include, but are not limited to:

  - Manufacturing & Fabrication,
  - Software Development,
  - Engineering, Architecture,
  - Pharmaceutical,
  - Machining,
  - Aerospace & Defense,
  - Food & Beverage,
  - Tool & Die Casting,
  - Foundries,
  - Automobile, and
  - Chemical & Formula

  The Research and Development tax credit is one of the most lucrative incentives under current U.S. tax law because it is a dollar-for-dollar reduction in a tax liability. Depending on a company's qualified research expenses, the credit can include eligible wages, supplies, and outside contractor expenses. In addition to the federal component, the vast majority of states also offer some form of the credit with many of those states offering a permanent form of the credit (please see kbkg.com/research-tax-credits/state-benefits for a list of states offering a research credit). Federal statutes are generally open for three years from the filing date of a return. As such, taxpayers who did not take advantage of the credit and are seeking to do so, can amend previous years' returns and claim the benefits. Federal statutes also allow for unused credits to be carried forward for 20 years. To see if your company qualifies or if you have any questions regarding the research credit, please contact our R&D tax credit professionals.

- Pass-Through Entities & Passive Losses

  To reduce 2020 taxable income, consider disposing of a passive activity in 2020. This will allow you to deduct suspended passive activity losses. If you own an interest in a partnership or S corporation, consider whether you need to increase your basis in the entity so you can deduct a loss from it for this year.

- Qualified Business Income Deduction for Pass-through Entities

  One of the biggest changes from the Tax Cuts and Jobs Act was the qualified business income (QBI) deduction, which continues to be in effect in 2020. This break is available to individuals, estates, and trusts that own interests in pass-through business entities. The deduction generally equals 20% of QBI, subject to restrictions that can apply at higher income levels.

  QBI is generally defined as the net amount of qualified items of income, gain, deduction, and loss from any qualified business of the noncorporate owner. For this purpose, qualified items are income, gain, deduction, and loss that are effectively connected with the conduct of a U.S. business.

  QBI does not include certain investment items, reasonable compensation paid to an owner for services rendered to the business, or any guaranteed payments to a partner or LLC member treated as a partner for services rendered to the partnership or LLC.

  Service business limitation. The QBI deduction generally is not available for income from specified service businesses (such as most professional practices other than engineering and architecture and businesses that involve investment-type services such as brokerage and investment advisory services). Under an exception, the service business limitation doesn't apply until an individual owner's taxable income exceeds $163,300 ($326,600 for joint filers). Above those income levels, the service business limitation is phased in over a $50,000 phase-in range ($100,000 range for joint filers).

  The QBI deduction is not allowed in calculating the owner's AGI, but it reduces taxable income. In effect, it is treated the same as an allowable itemized deduction.

  If the 199A deduction is limited by taxable income, additional income may get a 20% deduction even if it is not qualified business income (and not capital gains). When a taxpayer is within or over the phaseout range, reducing income or increasing deductions can increase the 199A deduction. Maximizing or minimizing depreciation and 179 deduction can be a useful tool to obtain a larger 199A deduction.

- Tentative Claims of Refunds

  The CARES Act included provisions to allow businesses and individuals to revisit prior year returns to take advantage of previously unavailable opportunities. Among them is the ability to accelerate corporate alternative minimum tax (AMT) credits to either 2018 or 2019 and carry back net operating losses (NOLs) arising in tax years beginning 2018, 2019, and 2020. The fastest way to obtain refunds using these methods is to file a tentative refund claim on Form 1139, but these must be filed by December 31, 2020.

- 2020 Election Considerations

  Historically, major tax legislation tends to occur soon after a presidential election. Most recently, the Affordable Care Act of 2010 after President Obama took office in 2009, and the Tax Cuts and Jobs Act enacted in President Trump's first year. While U.S. President-elect Joe Biden campaigned with one of the most significant tax plans in recent history, it may be difficult to pass significant tax legislation in the face of a global pandemic and divided nation. Nevertheless, it is important to consider planning tools that may benefit businesses under Biden's proposed laws.

  Accelerating income and postponing deductions. Under Biden's proposed tax plan, the corporate income tax rate would increase from a flat rate of 21% to 28%, the halfway mark between the current rate and the former 35% rate under President Obama. A 15% minimum tax on book income may also be imposed. For companies with foreign subsidiaries, the tax rate on Global Intangible Low Tax Income may double from 10.5% to 21%. With these proposed tax increases, taxpayers may choose to accelerate income into 2020 while simultaneously deferring expenses to 2021.

  Accelerating capital gains in pass-through entities. For individual taxpayers, Biden has proposed taxing capital gains as ordinary income if income exceeds $1M. This would nearly double the current rate from 20% to 39.6%. Pass-through entities may want to consider recognizing gains in 2020 that may have otherwise been recognized in early 2021.

California

- New Employment Credit

  For tax years beginning on or after January 1, 2014, and before January 1, 2026, a nonrefundable credit against corporation franchise and income and personal income taxes is available to qualified employers that hire qualified full-time employees to work in a designated census tract or economic development area (EDA) provided the taxpayer pays qualified wages and satisfies other procedural requirements. A "designated census tract" is a census tract determined by the Department of Finance to be in the top 25% of California census tracts in terms of civilian unemployment and poverty rates. For purposes of this credit, "economic development areas" are specified former enterprise zones or LAMBRAs. (Sec. 23626 (b) (7) and (8), Rev.& Tax. Code) A map and search tool with all of the designated census tracts and economic development areas is available on the FTB's website.

  In addition, an annual certification of employment is required with respect to each qualified full-time employee hired in a previous taxable year. To be allowed a credit, the qualified taxpayer must have a net increase in the total number of full-time employees in California.

- California Competes Tax Credit

  The California Competes Tax Credit is an income tax credit available to businesses that want to come to California or stay and grow in California. The credit is based on numerous factors, including the number of jobs created, geographical location, compensation paid to employees, and overall business economic impact. Tax credit agreements will be negotiated by GO-Biz and approved by a statutorily created "California Competes Tax Credit Committee," consisting of the State Treasurer, the Director of the Department of Finance, the Director of GO-Biz, and one appointee each by the Speaker of the Assembly and Senate Committee on Rules.

A total of $231,135,999 in California Competes Tax Credit is available for allocation in the 2020-2021 fiscal year. GO-Biz will accept applications for the California Competes Tax Credit during the following periods:

- January 4, 2021, through January 25, 2021 ($80 million available)
- March 8, 2021, through March 29, 2021 ($71.1 million, plus any remaining unallocated amounts from the previous application periods)

- College Access Tax Credit

  This credit is available through 2020 tax years for contributions made to the College Access Tax Credit Fund. The credit will be available to taxpayers who make cash contributions to the fund and who receive a credit certification and allocation from the California Educational Facilities Authority (CEFA) in the State Treasurer's Office. The fund will be used to bolster the dwindling resources used to provide Cal Grants to low-income college students. Taxpayers may claim credits for 50% of the amount contributed that is certified and allocated for the 2020 taxable year.

  The credit can be used to offset tax, including reducing the tax below the tentative minimum tax.

  You must receive a certificate from CEFA before you can claim the credit on your state income tax return. You may also be able to claim a charitable deduction on your federal tax return However, if you claim it, you must add back the amount of the charitable deduction taken on your federal return as a state adjustment on your California tax return. You cannot claim a deduction and a credit for the same contribution.

  The application period for the 2020 taxable year is open until 5 PM, January 4, 2021. You can get an application and more information about how to contribute on the CEFA's website.

These are just some of the year-end steps to save taxes for your business. Please feel free to contact our office so we can tailor a plan that will work best for you.

Sincerely,

KROST CPAs & Consultants

Contact us and we will tailor a plan that is specific to you and your needs

CONTACT US

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