2020 Year-End Tax Webinar

December 8, 2020

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Overview of Today's Discussion

- Current Tax Landscape & COVID-19 Tax Relief
  - CARES Act – Update on Tax Provision and Opportunities
  - PPP Update: Forgiveness, Tax Impact, and Other Considerations
  - Payroll Tax Credits and Incentives
- Post-Election Outlook & Planning
- Tax-Efficient Gifting Strategies
- Other Year-End Tax Planning Strategies
- State and Local Tax Update

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Current Tax Landscape & COVID-19 Tax Relief

- Coronavirus Aid, Relief, and Economic Security (CARES) Act signed into law by President Donald Trump on March 27, 2020
- Payroll Protection Program (PPP)
- Sec. 163(j) Interest Expense Limitation
- Bonus Depreciation
- Business Losses: Corporate & Flow-Through Entity Operating Losses
- §199A – 20% Business Income Deduction
- Payroll Tax Deferral & Credits
- Other COVID-19 Relief

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Paycheck Protection Program (PPP)

- The PPP, created as part of the CARES Act, authorized loans to certain businesses affected by the COVID-19 pandemic
- Businesses which used the loans on eligible expenses may be able to apply for loan forgiveness
- Loan Forgiveness Applications
- The CARES Act expressly provides that any forgiveness of all or part of such loans will not be treated as income

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PPP Expense Deductibility

- While the Act explicitly excludes the forgiveness of PPP loans from taxable income, it did not explicitly address the treatment of expenses used to support loan forgiveness
  - IRS issued a notice stating that expenses would be non-deductible
  - IRS issued guidance clarifying that expenses would not be deductible in the year incurred if there is a “reasonable expectation” of loan forgiveness
- Members of Congress have expressed dissatisfaction with the nondeductible treatment of expenses
- Additional legislation?

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Interest Expense Limitation Overview

- Tax Reform implemented a business interest limitation, which potentially reduces the business' cash flows
- The deductibility of business interest is limited to 30% of EBITDA
- Taxpayers with less than $25 million in annual gross receipts are generally exempt
- Real estate businesses with greater than $25 million in annual gross receipts can elect to fully deduct business interest

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Interest Expense Limitation – Update

- CARES Act increased the interest deduction limitation from 30% to 50% of EBITDA for 2020
- Taxpayers may elect to use 2019’s ATI in lieu of the 2020 ATI
- IRS Issues Final Regulations:
  - Narrows the definition of what constitutes interest
  - Clarifies the definition of EBITDA permitting most businesses to addback depreciation, amortization, and depletion through 2021

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100% Bonus Depreciation & Expensing

- Permits taxpayers to claim additional first-year depreciation on certain newly acquired property
- TCJA expanded 100% first-year bonus depreciation and expensing for property placed in service after September 27, 2017 through December 31, 2022
- CARES Act Fix - Qualified improvement property ("QIP") (e.g., 15-year property) is now eligible for bonus depreciation
- QIP includes qualified retail improvement property, restaurant property, and leasehold improvement property
- Taxpayers may claim a tax refund for missed bonus depreciation

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Business Losses: Corporate NOLs

- NOL Carrybacks
  - TCJA eliminated corporations' ability to carry back NOLS
  - CARES Act retroactively restored NOL carrybacks for corporations
  - Currently, NOLs which were generated during 2018, 2019, or 2020 are eligible to be carried back 5 years (to a 35% tax rate year)
- NOL Limitation
  - TCJA implemented an 80% taxable limitation on utilization of NOLs
  - CARES Act suspends the 80% taxable income limitation permitting businesses to use NOLs to fully offset their taxable income
- Opportunity to file amended returns to get refunds of taxes paid in prior years

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Business Losses: Excess Business Loss

- The TCJA limited net losses from pass-through entities to $250,000 ($500,000 for a married, filing jointly taxpayer)
- The CARES Act eliminates the limitation for 2018, 2019, and 2020
- Taxpayers may deduct 100% of the losses in those years, subject to other limitations (e.g., passive activity, at-risk limitations, etc.)
- Potential opportunity to claim refund on an amended return

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§199A – 20% Business Income Deduction

- The qualified business income (QBI) deduction provides a 20% reduction in taxable income for qualified pass-through income, subject to limitations
- Potentially reduces the highest effective tax rate for individuals with QBI from 37% to as low as 29.6%
- Qualified trade or business vs. specified service business
- The deduction is available for taxable years beginning after December 31, 2017 and ending on or before December 31, 2025

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Employee Retention Payroll Tax Credit

- Eligible employers can receive a refundable payroll tax credit
  - Employers whose operations have been fully/partially suspended due to COVID-19-related shutdown
  - Gross receipts have decreased more than 50% compared to same quarter in previous year
- Generally equal to 50% of the first $10,000 in qualified wages per employee paid between March 13, 2020 through December 31, 2020
- The credit applies against the employer’s portion of the 6.2% FICA tax, but any excess is refundable
- Not eligible if received a PPP Loan

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Employers Payroll Tax Deferral

- CARES Act permits employers to defer payment for the employer portion of payroll taxes
- Employer defers 50% of payment until December 31, 2021
- Remaining 50% payment is deferred until December 31, 2022
- Does not appear to be available for the self-employed

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Paid Leave Credit (FFCRA)

- The Families First Coronavirus Response Act (FFCRA) generally required employers with fewer than 500 employees to provide paid leave in certain COVID-19-related situations
- Covered employers can take a refundable federal payroll tax credit for 100% of qualified sick and family leave wages
  - Up to $511 per day for employee's illnesses and $200 per day for leaves taken to care for others

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Other COVID-19 Relief

Charitable Contributions:

- For corporations, deduction limits increased from 10% to 25% for 2020
- For individuals, the limitation based upon adjusted gross income has been suspended, so unlimited charitable deductions (to the extent of AGI) may be claimed in 2020

Alternative Minimum Tax Credit:

- The CARES Act accelerates the ability of corporations to recover excess minimum tax credits

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Post-Election Outlook

- One thing is certain: CHANGE!
- However, the Democrat’s modest gains in Senate presumably dampens the potential significant tax changes in 2021
- House Majority Party: Democratic Party
- Senate: Subject to the Georgia Senate Run-Off

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Biden's Tax Proposals

- Corporate Income Tax:
  - Tax rate increase from 21% to 28%
  - Minimum tax of 15% on book income
- Pass-Through / Individual Income Tax:
  - Increase individuals' tax rate from 37% to 39.6%
  - 20% business income deduction include unfavorable modifications to the real estate industry and an overall phaseout for taxpayers with income above $400,000
  - Individuals with income >$1,000,000: Long-term capital gains and qualified dividends may be taxed at ordinary income rates instead of capital gain rates

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Biden’s Tax Proposals, cont.

- Estate Taxes
  - Estate tax rates could be increased
  - Step-up in basis for property transferred at death to be eliminated
  - Lifetime gift and estate exemption
    - Under current law, the amount is $11.58 million and will decrease to $5 million in 2026.
- Payroll Taxes
  - Expand Social Security payroll tax (6.2% tax)

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Planning in Election Year

- Uncertainty about the Senate composition due to the runoff election complicates planning and expectations
- Defer Income and accelerate deductions?
- Estate tax planning

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Creative Tax-Efficient Gifting Strategies

- Donor-Advised Funds
- Annual Gift Tax Exclusion
- Lifetime Exemption – Rely on valuation discounts
- Gifts of appreciated property to shift taxable gain to lower-bracket family members
- Gifts for tuition and medical expenses
- Increase charitable contribution deduction (CARES Act)
- Contribution of appreciated capital gain property
- Charitable Remainder Trusts / Charitable Lead Trusts

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Year-End Tax Planning Strategies

- Shift Income and Expenses
- Cash Basis Taxpayers
  - Defer income if not actually or constructively received during 2020
  - Accelerate/pre-pay payment of expenses (e.g., year-end bonuses, etc.)
- Accrual Basis Taxpayers
  - Defer inclusion of certain advance payments
  - Accelerate expenses using recurring item exception
- Bonus depreciation / CAPEX expensing
- Increase withholding to avoid the estimated tax underpayment penalty
- Reduce or eliminate the 3.8% Net Investment Income Tax
- Accounting Method Review

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Year-End Tax Planning Strategies, cont.

- Plan for capital gains and losses and for passive activity
- Gain exclusion/deferral on sale of small business stock
- Home Office Deduction (Self-Employed Individuals)
- Consider deferring cancellation of indebtedness
- Determine tax basis in flow-through entities to utilize flow-through losses
- Review entity structure (C-Corp vs. flow-through entities)
- Converting traditional IRAs to Roth IRAs
- Installment method to defer taxable gain on sales

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Qualified Opportunity Zone (QOZ)

- Incentives introduced by the TCJA to encourage investment in businesses operating in certain low-income, distressed communities
- Taxpayer can defer or exclude tax on certain capital gains if reinvested in a QOZ
- Extended deadline ends December 31, 2020

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State and Local Tax

- Impact of Remote Employees
  - Withholding Considerations
  - Nexus Considerations
- SALT deduction $10k cap workaround
  - The IRS recently issued a Notice which would effectively allow owners of pass-through entities to deduct state and local taxes on their individual tax returns
- Wayfair Update: 43 states have enacted economic nexus for sales tax

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Questions?

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