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Business Tax Planning

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Stancil CPAs • Advisors | December 2, 2020

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Welcome to Planning for Business! Topics to be covered today:

- Potential Tax Changes for Businesses Under President Biden
- Qualified Business Income Tax Deduction - The Best Tax Plan for Passthrough Entities
- Maximize Depreciation of Fixed Assets
- Don't Just Tax Plan - Make Sure Your Business is Operating at Optimum Levels
- COVID-Related Programs for Businesses

POTENTIAL TAX CHANGES FOR BUSINESSES UNDER PRESIDENT BIDEN

Presented by: S. Scott Hensley, CPA | shensley@stancilcpa.com

Changes to Corporate Tax Rate Structure

- Corporate tax rate would increase from 21% to 28% flat tax rate.
  - Depending on total income, a conversion to an S corporation would be beneficial.
  - This rate is still lower than the former rate of 35% pre-2018 tax cuts.
- A new Corporate Alternative Minimum Tax based on financial statement earnings. For all corporations with financial statement income in excess of $100 million, the corporation would have a 15% minimum tax on the financial statement income no matter what the taxable income is.
- On top of these tax increases to corporations, the Plan calls for a 10% surtax on profits of foreign production. Along the same lines, the Plan calls for a 10% credit if jobs and/or production are moved back to the U.S.

Other Business Changes

- For all employees earning more than $400,000, the social security withholding will kick in at $400,000 of taxable wages. The employer must contribute 6.2% and the employee must contribute 6.2% on all earnings above $400,000.
- Phase out of the 20% qualified business income deduction for taxpayers with taxable income in excess of $400,000.
  - Currently, this only applies to taxpayers in a specified service business.
  - This proposal would apply the phase-out to all businesses.
  - Planning techniques include accelerated depreciation and cash balance plans to reduce taxable income.

QUALIFIED BUSINESS INCOME TAX DEDUCTION - THE BEST TAX PLAN FOR PASSTHROUGH ENTITIES

Presented by: Ryan Christians, CPA | rchristians@stancilcpa.com

Qualified Business Income Deduction (199A Deduction)

- Trade or business income from the following activities now qualify for a 20% deduction on the total income subject to certain limitations:
  - Qualifying Activities – Pass-through income from S corporations, partnerships, estates and trusts. Qualifying rental activities, sole proprietors, qualified REIT dividends and income from PTP that is not treated as a corporation.
    - Note – Rental activities are allowed to the extent they are classified as a trade or business.
  - Does not include W-2 wages or guaranteed payments made to partners.

Limitations on the Deduction

- If taxable income is below $163,300 for single or $326,600 for MFJ, then no limitation.
- If taxable income exceeds these limits, then the following are limited:
  - Specified Service Trade or Business (SSTB) industries phase out completely over the next $50,000 of taxable income for single and $100,000 for MFJ.
  - Additional limitation for all other industries above these amounts is lesser of (A) or (B):
    - (A) 20% of trade or business income
    - (B) 50% of allocated W-2 wages from business, OR
    - 25% of allocated W-2 wages plus 2.5% of unadjusted basis of tangible depreciable at end-of-year

Specified Service Trade or Businesses Industries

- Field of Law
- Field of Health
- Field of Accounting
- Brokerage Services (Investment, not Real Estate)
- Actuarial Services
- Performing Arts
- Financial Services
- Investment Managing or Planning
- Consulting Services (Seek CPA help – this is not as broad as it sounds)

199A Example #1

Facts:

- Married Couple – one spouse earns $100,000 of W-2 wages.
- Spouse has a net profit of $200,000 from their real estate sales (Schedule C).
- Total adjusted gross income is $300,000.
- Couple does not itemize so they take a $24,800 standard deduction:
  - Without considering the 199A deduction – federal tax (including SE tax) is ~ $74,000.
  - Approximate Section 199A deduction = 20% of $200,000, or $40,000.
  - With the 199A deduction – federal tax (including SE tax) is $65,000.
  - Savings of $9,000.
  - Note – Section 199A deduction does not reduce self-employment tax.

199A Example #2 – Potential Savings from Forming S-Corporation

Facts:

- Married Couple – one spouse earns $100,000 of W-2 wages.
- Spouse has a net profit of $400,000 from their real estate sales.
- The real estate business is now being reported as an S-corporation.
- Spouse takes 50% ($200,000) of profit in salary, remainder in distributions.
- Total adjusted gross income is $500,000.
- Couple does not itemize so they take a $24,800 standard deduction:
  - Section 199A deduction is 20% of $200,000, or $40,000.
  - Savings are ~ $20,000 per year (from reduction in SE taxes and increased 199A deduction).
  - Compliance costs ~ $2,500 per year

199A deduction would be lost without incorporation due to $0 wages and being over $326,600 taxable income.

Salary choice with a S-corporation is a key topic to discuss with your CPA. This is a key audit area of the IRS.

199A Example #3

Facts:

- Single Individual with a net profit of $250,000 from their legal practice reported on a Schedule C
- Taxpayer does not itemize so they take a $12,400 standard deduction:
  - Section 199A deduction is $0 since the taxpayer is a SSTB over $213,600.
  - With a SEP contribution of $40,000, taxpayer could reduce income enough to bring back some 199A deduction.
  - Tax savings would be ~ 22,300, so the net cost to the SEP is only $17,700.
  - This is an example of a taxpayer with a narrow marginal rate of close to 55%.
  - Other similar savings could come from buying equipment and accelerating deductions.
  - For taxpayers who are a SSTB with incomes near the phase-out range, proper tax planning is key to staying out of this 50%+ marginal tax bracket.

MAXIMIZE DEPRECIATION OF FIXED ASSETS

Presented by: Charles Garrison, CPA | cgarrison@stancilcpa.com

I. CARES Act's Expansion of Bonus Deprecation to Qualified Improvement Property ("QIP")

- QIP typically includes interior improvements made by owner to a building
- Includes neither
  - New construction that is placed in service with the building NOR
  - Internal structural framework, enlargement and expansion
- Changes the depreciable life from 39 years to 15 years
- Practitioners consider this a correction of an oversight by the previous Act
- Retroactive to January 1, 2018

II. Bonus Depreciation

- 100% write-off includes furniture and fixtures, equipment, software, QIP and land improvements
- Automatic election
- A statement is required to elect to opt out of bonus depreciation

III. Tools Used to Maximize Bonus Depreciation

- Communication!
  - Understand the assets acquired or constructed
  - Share appraisals or property condition assessment reports to identify assets qualifying for bonus depreciation
- Cost segregation studies

III. Tools Used to Maximize Bonus Depreciation

- Amending the prior year's return
  - Use when "missed" the immediately preceding year
  - Note total cost is not just amending a partnership or S Corporation ("PTE") return but you also amend the individual members or shareholders returns.

III. Tools Used to Maximize Bonus Depreciation

- Filing a Form 3115 for change of accounting method:
  - Catches up all prior depreciation expense "missed."
  - Avoids amending prior years' returns for PTE, plus all K-1 recipients.
  - Automatic method change!
    - Deemed from an impermissible to permissible method.
    - No filing fees!
    - Can be filed with an extended return!
  - Arguably, one of the most important and powerful tools in a CPA's toolkit.

IV. Section 179 Expensing

- Generally applies to non-building assets.
  - Not available for new construction.
  - Does include improvements to non-residential property like roofs, HVAC systems, and fire, alarm and security systems.
- Maximum deduction equals $1M.
- Begins to phase out when capital expenditure for eligible assets exceeds $2.5M

V. When Considering Bonus Depreciation or 179 Expensing, Let's Be Mindful of:

- Tax economics of the transaction:
  - Recapture of bonus depreciation as ordinary income.
  - Do you plan to flip within 3 to seven years?
  - Do we anticipate your marginal rate increasing?
- State and local tax "decoupling" from either accelerated method:
  - North Carolina decoupled from bonus years ago.
  - Cost of maintaining multiple fixed asset reports for state(s) with bonus depreciation.
- Passive loss limitations including self-use property recharacterization (ugh).
- QBI impact from claiming bonus depreciation.

V. When Considering Bonus Depreciation or 179 Expensing, Let's Be Mindful of:

- IRC 1031 exchange concerns under 2017 Act:
  - Matters include defining what is real property for 1031 purposes.
    - State or local laws in which the property is located determine if property is classified as real property
    - Specifically listed as real property in final regulations, OR
    - Considered real property based on all the facts and circumstances under the various factors provided in the final regulations.
  - Really? Thank you, Treasury, for increasing our bills… Simplification never seemed so… simple?
  - What is the deemed incidental to a larger property?
  - Aggregate FMV of all incidental property does not exceed 15% of aggregate FMV of the larger item of property.

V. When Considering Bonus Depreciation or 179 Expensing, Let's Be Mindful of:

- Allocation of purchase price when acquiring business assets (vs. stock sale).
  - Natural friction point between SELLER and BUYER:
    - SELLER may prefer minimal allocation of purchase price to qualifying assets
      - Why?
      - Capital gains tax rate vs. ordinary income tax rate
      - Gain attributable to depreciation recapture will be subject to ordinary income tax rate
      - Gain attributable to Class VII, Business Goodwill, will be subject to capital gain tax rate plus NIIT
      - Gain attributable to Class VII, Personal Goodwill, will be subject to capital tax gain rate only (NO NIIT!)

V. When Considering Bonus Depreciation or 179 Expensing, Let's Be Mindful of:

- BUYER may prefer to allocate more of the purchase price to Class V's assets qualifying for accelerated deprecation methods.
  - Why?
  - Use of either bonus depreciation or 179 expense.
  - Potential costs may be state and local taxes likes sales & use tax or business personal property tax.

DON'T JUST TAX PLAN - MAKE SURE YOUR BUSINESS IS OPERATING AT OPTIMUM LEVELS

Presented by: David Piscorik, CPA | dpiscorik@stancilcpa.com

Small Business Accounting Services Offering

“We provide more than just a bookkeeper, we provide you with a complete, integrated accounting/finance department.”

- Certified QuickBooks Pro Advisor
- CPA Oversight
- Tax planning and compliance

Accounting Oversight Service

Works with the business owner and/or existing staff in helping maintain QuickBooks.

- QuickBooks training resource
- Client records all day-to-day activities in QuickBooks
- Stancil reconciles all accounts, reviews all general ledger transactions, and provides financial statements and business consultation on a monthly or quarterly basis.

Accounting Outsourcing Service

Maintain QuickBooks on client's behalf, executing business owner's decisions.

- We record and reconcile all transactions in QuickBooks on client's behalf.
- We provide financial statements and business consultation on a monthly or quarterly basis.

Benefits of Outsourcing Accounting

- Accuracy - dedicated team of certified QuickBooks professionals.
- Affordability - low monthly fixed fee.
- Reliability - QuickBooks support and training is just a quick phone call, text or email away.
- Timeliness - Timely monthly financial reporting available for management use.
- Transparency - We integrate directly into your existing system with no disruption to your business.

Fractional CFO Service Offering

- Establish/Review internal control structure/segregation of duties
- Establish/Review financial close cycle
- Establish/Review financial dashboard/KPIs
- Review financial statements/analysis
- Establish/Review financial budget(s)
- Establish/Review financial forecasts
- Establish/Review cash flow forecasts
- Establish/Review board financial package

Fractional CFO Service Offering

- Establish/Review organization chart, financial policies and procedures
- Establish/Review tax minimization strategies
- Assist in annual audit preparation
- Assist in due diligence in acquiring/selling business
- Assist in creating staff incentive programs
- Assess current software needs/assist in software migration
- Assist in financing capital expenditure needs
- Assist in hiring accounting staff

Year-End Planning Checklist

- Accurate closing of November financials
- Update accounts receivable, write-off bad debts, and update allowance for bad debts
- Update capital expenditures/depreciation expense
- Equitable owner distributions
- Adequate shareholder basis for distributions

Year-End Payroll Reporting

- Personal Use of Company Car (PUCC)
- Taxable Group Term Life Insurance (reported on W-2)
- Health insurance reporting on W-2
- Form 1099
  - Ensure collection of EIN#s (I-9 forms)
  - New Form 1099-NEC
    - Box 7 non-employee compensation
- Update your ESC rate for 2021

COVID RELATED PROGRAMS FOR BUSINESSES

Presented by: S. Scott Hensley, CPA | shensley@stancilcpa.com

Paycheck Protection Program (PPP)

- Forgiveness applications are due 10 months after the end of the Covered Period
  - The SBA has 3 different applications available - 3508, 3508-EZ, and 3508S
  - Before applying, beware of pitfalls. If either of these apply, then you should NOT file until 2021:
    - If you reduced FTE's during the Covered Period, then you have until December 31, 2020, to bring FTE's back to February 15th levels.
    - If you reduced wages by more than 25% during the Covered Period, then you have until December 31, 2020, to raise these wages back to original levels.
- The IRS has ruled that any amount that is forgiven will have a tax effect such that the PPP proceeds are taxable in 2020.

Sick Leave and Family & Medical Leave Credit

- If an employee missed time at work due to COVID implications, then the employer is entitled to a payroll tax credit equal to the amount paid for sick leave.
  - If leave is for the following reasons, then a full-time employee is entitled to receive payment at their regular pay rate up to $511 per day and $5,110 in total of sick leave pay (up to 80 hours). If the employee was a part-time employee, then the employee is allowed the prorated amount that the employee normally works during a 40- hour work week.
    - Employee is quarantined due to a government order or by advice of a health care provider; OR
    - Employee is experiencing COVID-19 symptoms and seeking a medical diagnosis.

Sick Leave and Family & Medical Leave Credit

- If leave is for the following reasons, then the full-time employee is entitled to receive payment at 2/3 of their regular pay rate up to $200 per day and $2,000 in total of sick leave pay (up to 80 hours). If the employee was a part time employee, then the employee is allowed the prorated amount that the employee normally works during a 40-hour work week.
  - Employee is unable to work because of a bona fide need to care for an individual that is under quarantine by the government or advice of a health professional; OR
  - Employee must care for a child under the age of 18 whose school or care provider is closed due to COVID-19; OR
  - Employee is experiencing substantially similar conditions that are related to COVID-19.

Sick Leave and Family & Medical Leave Credit

- In addition to Sick Leave, an employer must provide Family & Medical Leave in excess of the 80 hours of sick leave. The employer is allowed a credit for this additional payment of leave as well. The extended leave permits the employee to receive 2/3 of their normal pay up to $200 per day and $10,000 total over a 10-week period.
- The requirements of the additional leave are as follows:
  - The employee must have exhausted the 80 hours of sick leave.
  - The employee must have been employed for 30 days prior to applying for extended leave.
  - The employee must not be able to perform their normal duties either at work or through teleworking (if the employer permits teleworking).
  - The inability to work must be related to caring for a child under the age of 18 whose school or care provider has closed due to COVID-19.

Employee Retention Credit

- Refundable credit for up to 50% of wages up to $10,000 per worker
- Eligible employers include the following:
  - Employer's business had a full or partial shutdown of operations by government order; OR
  - Gross receipts declined by more than 50% after COVID.
- Employers are NOT eligible for the credit if they received a PPP Loan.

Payroll Tax Deferral

- Employer may defer payment of the employer's portion of social security through December 31, 2020 until 2021 and 2022.
- Half is due by December 31, 2021 and half is due by December 31, 2022.

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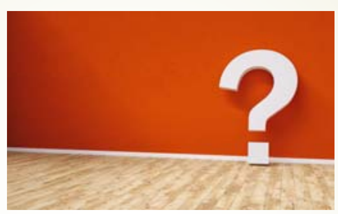
QUESTIONS???



Thank you for attending!

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