To Our Clients and Friends:

2020 has been quite a challenge, to say the least. The COVID-19 crisis brought massive unemployment, business closures, and an enormous amount of uncertainty. All of this has made 2020 seem like the year that never ends. In fact, I'm sure some of us can't wait for it to be over. As we approach the end of the year, it's time to discuss steps that can be taken to help reduce your 2020 tax bill.

The past 12 months have seen several major tax law changes. In response to the COVID-19 emergency, the Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law in March. In addition, the Taxpayer Certainty and Disaster Tax Relief Act (Disaster Act) and the Setting Every Community Up for Retirement Enhancement (SECURE) Act were passed in December 2019. The Disaster Act extended many beneficial provisions that had expired or were set to expire. Barring additional extenders, many of these will expire again at the end of the year. The SECURE Act, on the other hand, made significant changes to the retirement rules. We'll highlight planning techniques stemming from these recent bills, as well as other year-end planning ideas.

Let's not forget that there is an election in November. While we don't anticipate significant tax law changes if President Trump is re-elected, a victory by Joe Biden would almost certainly lead to tax reform (with potentially higher tax rates). It's also possible that we'll see additional COVID-19 legislation. As always, we're paying close attention to the ever-changing tax environment to discover tax planning opportunities.

Year-end Planning Moves for Small Businesses

Net Operating Losses (NOLs). The CARES Act temporarily relaxed many of the NOL limitations that were implemented under the Tax Cuts and Jobs Act (TCJA). If your small business expects a loss in 2020, know that you will be able to carry back 100% of that loss to the prior five tax years. If you had an NOL carried into 2020, you can claim a deduction equal to 100% of your 2020 taxable income.

Establish a Tax-favored Retirement Plan. If your business doesn't already have a retirement plan, now might be the time to take the plunge. Current retirement plan rules allow for significant deductible contributions. For example, if you're self-employed and set up a SEP-IRA, you can contribute up to 20% of your self-employment earnings, with a maximum contribution of $57,000 for 2020. If you're employed by your own corporation, up to 25% of your salary can be contributed with a maximum contribution of $57,000.

Other small business retirement plan options include the 401(k) plan (which can be set up for just one person), the defined benefit pension plan, and the SIMPLE-IRA. Depending on your circumstances, these other types of plans may allow bigger deductible contributions.

The SECURE Act offers an additional incentive for establishing a retirement plan in 2020. The credit for employers that adopt a new eligible plan is increased from $500 to a maximum of $5,000, and a $500 credit has been added for new small employer plans with an auto-enrollment feature.

Contact us for more information on small business retirement plan alternatives, and be aware that if your business has employees, you may have to cover them too.

Take Advantage of Generous Depreciation Tax Breaks. 100% first-year bonus depreciation is available for qualified new and used property that is acquired and placed in service in calendar-year 2020. That means your business might be able to write off the entire cost of some or all of your 2020 asset additions on this year's return. So, consider making additional acquisitions between now and year-end.

Also, the CARES Act made a technical correction to the TCJA that retroactively treats a wide variety of interior, non-load-bearing building improvements [known as *Qualified Improvement Property (QIP)*] as eligible for bonus deprecation (and hence a 100% write-off). Alternatively, if you elect out of bonus depreciation, you can depreciate QIP over 15 years (rather than the 39 years provided by the TCJA). Small businesses can take advantage of this provision by filing for a change in accounting method or by amending the applicable return. Contact us for more details.

<u>Claim 100% Bonus Depreciation for Heavy SUVs, Pickups, or Vans.</u> The 100% bonus depreciation provision can have a hugely beneficial impact on first-year depreciation deductions for new and used heavy vehicles used over 50% for business. That's because heavy SUVs, pickups, and vans are treated for tax purposes as transportation equipment that qualifies for 100% bonus depreciation. However, 100% bonus depreciation is only available when the SUV, pickup, or van has a manufacturer's Gross Vehicle Weight Rating (GVWR) above 6,000 pounds. The GVWR of a vehicle can be verified by looking at the manufacturer's label, which is usually found on the inside edge of the driver's side door where the door hinges meet the frame. If you are considering buying an eligible vehicle, doing so and placing it in service before the end of this tax year could deliver a juicy write-off on this year's return.

<u>Claim First-year Depreciation Deductions for Cars, Light Trucks, and Light Vans.</u> For both new and used passenger vehicles (meaning cars and light trucks and vans) that are acquired and placed in service in 2020, the luxury auto depreciation limits are as follows:

- $18,100 for Year 1 if bonus depreciation is claimed.
- $16,100 for Year 2.
- $9,700 for Year 3.
- $5,760 for Year 4 and thereafter until the vehicle is fully depreciated.

Note that the $18,100 first-year luxury auto depreciation limit only applies to vehicles that cost $58,500 or more. Vehicles that cost less are depreciated over six tax years using percentages based on their cost. Contact us for details.

Cash in on Generous Section 179 Deduction Rules. For qualifying property placed in service in tax years beginning in 2020, the maximum Section 179 deduction is $1.04 million. The Section 179 deduction phase-out threshold amount is $2.59 million.

Time Business Income and Deductions for Tax Savings. If you conduct your business using a pass-through entity (sole proprietorship, S corporation, LLC, or partnership), your shares of the business's income and deductions are passed through to you and taxed at your personal rates. If you assume next year's individual federal income tax rate brackets will be roughly the same as this year's, the traditional strategy of deferring income into next year while accelerating deductible expenditures into this year makes sense if you expect to be in the same or lower tax bracket next year. Deferring income and accelerating deductions will, at a minimum, postpone part of your tax bill from 2020 until 2021.

However, it's quite likely that 2020 was a comparatively bad year thanks to COVID-19. Hopefully, you expect to be in a higher tax bracket in 2021. If so, take the opposite approach. Accelerate income into this year (if possible) and postpone deductible expenditures until 2021. That way, more income will be taxed at this year's lower rate instead of next year's higher rate. Contact us for more information on timing strategies.

Watch out for Business Interest Expense Limit. The CARES Act temporarily relaxed the unfavorable TCJA limitation on a taxpayer's deduction for business interest expense. Under the TCJA, the deduction was limited to the sum of (1) business interest income, (2) 30% of adjusted taxable income, and (3) floor plan financing interest paid by certain vehicle dealers. For 2020, the 30% limit has been increased to 50% of adjusted taxable income. Barring additional legislation, the limit will go back to 30% in 2021. The rules for businesses conducted as partnerships, LLCs treated as partnerships for tax purposes, and S corporations are especially complicated.

Fortunately, many businesses are exempt from the interest expense limit rules under the *small business exception.* Under this exception, a taxpayer is generally exempt from the limit if average annual gross receipts are $26 million (the inflation-adjusted amount for 2020) or less for the three-tax-year period ending with the preceding tax year.

Certain real estate and farming businesses with average annual gross receipts above the threshold also are exempt if they choose to limit their depreciation deductions. In light of the technical correction provided by the CARES Act allowing for faster write-offs of QIP, taxpayers who made the election to limit depreciation are now able to retroactively revoke that election.

The CARES Act also allows businesses to elect to use their 2019 adjusted taxable income in calculating their 2020 limitation. If average annual receipts are typically over the applicable threshold ($26 million for 2020), but not by much, some judicious year-end tax planning may allow your business to qualify for the small business exception for at least some years. We can help with that. Contact us for details if you think your business might be affected by the interest expense limit.

Conclusion

This letter only covers some of the year-end tax planning moves that could potentially benefit you, your loved ones, and your business. Please contact us if you have questions, want more information, or would like us to help in designing a year-end planning package that delivers the best tax results for your particular circumstances.

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