Business Tax Planning Ideas That May Help You Save Tax Dollars

The last few months of the year are important and year-end tax planning may allow you to change the entire course of your business. As 2020 approaches, it is time to develop, finalize, and undertake a year-end tax planning strategy. Businesses that have not yet explored year-end tax planning should take an immediate inventory of their situation and develop a year-end 2019 tax strategy to avoid missing out on tax saving opportunities. Whether it be refining past plans, delivering new plans, 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 that 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.

Federal

- **Bonus Depreciation and Code Section 179 Expensing**
  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 2019. Both used equipment and new equipment qualifies. Section 179 deduction limit increased to $1,020,000 for 2019 from $1,000,000 in 2018. These two incentives can provide significant tax relief in 2019 if financed and in place-in-service by midnight December 31, 2019.

- **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 Research and Development 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 R&D 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 visit 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 one of our R&D tax credit professionals (kbkg.com/research-tax-credits).

- **Pass-Through Entities & Passive Losses**
  To reduce 2019 taxable income, consider disposing of a passive activity in 2019. Doing so 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. Currently, owners of partnerships, S corporations, and sole proprietorships pay tax at the new individual tax rates, with the highest at 37%.

- **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 2019. 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 doesn't 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 isn't 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 $160,700 ($312,400 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 isn't allowed in calculating the owner's AGI, but it reduces taxable income. In effect, it's 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's 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 199A deduction. Maximizing or minimizing depreciation and 179 deduction can be a useful tool to archive a bigger 199A deduction.

- **Small Business Taxpayer Changing to Overall Cash Method**
  To qualify as a small business in 2019, a taxpayer must satisfy the gross receipts test. To pass the gross receipts test, the average of the last 3 years' gross receipts cannot exceed $26 million, (up from $25 million in 2018 and up from $5 million in 2017). With the requirement increased to $26 million, more taxpayers may be defined as a small business and may find it much easier to shift income or accelerate expenses as a cash method taxpayer rather than an accrual method taxpayer. This allows for more tax planning and tax savings opportunities.

California

- **New Employment Credit**
  For tax years beginning on or after January 1, 2014 and before January 1, 2021, 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 as 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 at: http://maps.gis.ca.gov/gobiz/dga/default.aspx.

  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, one appointee each by the Speaker of the Assembly and Senate Committee on Rules.

A total of $236,808,527 in California Competes Tax Credit is available for allocation in the 2019-2020 fiscal year. GO-Biz will accept applications for the California Competes Tax Credit during the following periods:

- January 6, 2020, through January 27, 2020 ($75 million available)
- March 9, 2020, through March 30, 2020 ($71.8 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 2019 taxable year.

  The credit can be used to offset tax, including reducing the tax below 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. If you do this, 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 2019 taxable year is open until 5pm on January 2, 2020. You can get an application and more information about how to contribute on CEFA's website at: http://www.treasurer.ca.gov/cefa/catc/index.asp.

These are just some of the year-end steps that can be taken 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.