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2020 Tax Planning in Uncertain Times: Which Choices are Best for You?

DECEMBER 4, 2020

11:00 a.m. to 12:00 noon

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Paul K. Rudoy joined H2R CPA in 1983 and is currently the firm’s Managing Partner. Paul specializes in strategic consulting, tax and wealth management for high net worth individuals and closely held businesses.

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Lucas Rihely is a Tax Partner with H2R CPA. With over a decade of public accounting experience, he focuses his practice on providing tax planning and compliance services to closely held businesses, their owners and other high net worth individuals. Lucas serves among the Firm's tax leadership in analyzing new laws and developing client strategies.

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William M. Bodnar has more than 35 years of professional accounting experience. He has directed all aspects of tax consulting and compliance engagements primarily for privately held corporate and pass-through entities, including individual shareholders/principals. He also has diverse industry experience with specialization in construction and manufacturing companies.

Bill provides a wide range of tax services to clients including: tax consulting for business formation, acquisitions and disposition; accounting for income taxes; property transactions and like-kind exchanges; management of IRS examinations; compensation and reporting matters; executive tax and financial planning; accounting method changes; and state and local tax reporting.

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Phillip D. Zlokas is a Tax Manager at H2R CPA with more than 12 years of public accounting experience. He specializes in providing tax services and consulting to individuals, trusts, partnerships and corporations in various industries. His industry focus includes oil & gas, sports franchises, and residential & non-residential real estate and construction. He is also experienced with the management of IRS examinations and tax planning for individuals.

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Potential Changes to the Tax Code and the Impact of Those Changes

PAUL RUDOY

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Who will be impacted?

- All taxpayers will be affected by a change in control of the White House
- Some taxpayers will see their tax reduced, and some will see increases and they may be significant
- Historically, change has occurred in the second year of an administration, which would be 2022. Due to the extremes of our deficit and the plans for the new administration, we may see retroactive tax changes to the beginning of 2021.
- The two senate runoffs elections in Georgia will go a long way in determining tax change implementation. If the Democrats win both those races in early January, the Democrats will have control of the White House, the House and the Senate.

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Areas of most dramatic change anticipated

- Estate Tax Exemption and the step up in basis
- Income tax rates for those with incomes higher than $400,000
- Capital Gains and qualified dividends rates for those with incomes higher than $400,000
- Corporate Tax Rates
- Social Security Tax on income of over $400,000

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Estate Tax Exemption and the Step-Up in Basis

- Currently 99.93% of Estates owe no Federal Estate Tax upon their deaths. (According to the Tax Policy Center)
  - ✓ A projection of 1,900 Americans in 2020. This number was 50,500 in 2001 (According to the Tax Policy Center)
- Pennsylvania also assesses an Inheritance tax that is not likely to change that has a flat rate of 0%, 4.5%, 12% or 15% depending on your heirs
- The current Federal Estate Tax Exemption is $11.58M per person
  - ✓ Scheduled to increase to $11.70M in 2021
- Discussed changes have the Estate Exemption dropping to anywhere between $3.5M per person to $5.6M per person
  - ✓ Discussion about the Federal Estate Tax Rate increasing to 45% from 40%

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Estate Tax Exemption and the Step-Up in Basis *(cont'd)*

- For children that inherit from a married couple with assets of say \$10M, they currently would owe no Federal Estate Tax
- If the exemption would drop to \$3.5M each and the rate would go up to 45%, the Federal Estate Tax would then be \$1.35M
- This makes utilizing gifting as an important strategy
- You can gift up to \$15,000 a year per person and also use part of your Estate Tax Exemption
- With the exemption decreasing, this could be your last chance to use it

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Estate Tax Exemption and the Step-Up in Basis *(cont'd)*

- Currently heirs receive estate assets with a stepped basis, which equates to fair market value
- This is why many seniors never sell appreciated securities and just let those holdings go to their children who can sell soon after death with no income tax consequences
- The discussed proposal eliminates the step up in basis
- This would be an administrative nightmare
- This should cause those with over $3.5M estates to evaluate whether they should gift, sell and looking at tax brackets of those you would gift to

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Income Tax Rates for Those with Incomes Higher than $400,000

- Individual Income Tax Rates currently top out at 37% for married filers exceeding $622,051 in taxable income and $518,401 for single taxpayers
- A discussed proposal would increase the rate to 39.6%, which was the pre-TCJA top rate
- The new 39.6% bracket would begin at $400,000

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Capital Gains and Qualified Dividends Rates for Those with Incomes Higher than $400,000

- Capital Gains and qualified Dividends are currently taxed at 15% or 20%
- Discussed changes would increase this to ordinary rates, or 39.6%, for those with taxable incomes of $1M or more
- This should cause you to re-evaluate your portfolio taxation strategies

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Potential Changes to the Tax Code and the Impact of Those Changes

Corporate Tax Rates

- Corporate tax rates were 15-35% prior to TCJA
- TCJA changed to a 21% flat rate
- Discussed changes move to 28%
- Doubles the GILTI tax on foreign earnings to 21%
- Implements a Minimum Corporate Tax for those with book profit of over $100M
- Adds many new tax credits

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Social Security Tax on Income of Over $400,000

- In 2020, social security is assessed on your first $137,700 of earnings
- Change would be to resume the taxation (6.2%) on earnings over $400,000
- This would be an employee and employer tax
- This should give you reason to look at your compensation arrangements

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Coronavirus Aid, Relief, and Economic Security Act – Key Considerations

PHIL ZLOKAS

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Beneficial Tax Provisions Expiring in 2020

- Temporary Suspension of NOL changes enacted by TCJA
- Temporary Suspension of Excess Business Loss Limitation
- Deferral of Payment of Employer Social Security Tax

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Net Operating Losses

- Post-TCJA
  - ✓ NOLs no longer able to be carried back, but have indefinite carry forward
  - ✓ Deduction for NOLs limited to 80% of taxable income

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Net Operating Losses *(cont'd)*

- CARES Act
  - ✓ For NOLs originating in tax years beginning after Dec. 31, 2017 and before Jan. 1, 2021
    - No limitation on deductibility
    - 5-year carryback instituted
- Post-CARES Act
  - ✓ Temporary Suspension = TCJA rules back in effect beginning Jan. 1, 2021
    - NOLs originating in 2018-2020 but not carried back or used before 2021 become subject to TCJA limitations after 2020

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Excess Business Loss Limitation

- Post-TCJA
  - ✓ Aggregate business losses limited to $250,000 (if not MFJ) or $500,000 (if MFJ), adjusted annually for inflation
  - ✓ Disallowed excess business loss carried forward to following tax year as NOL
  - ✓ Provision applies to noncorporate taxpayers

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Excess Business Loss Limitation *(cont'd)*

- CARES Act
  - ✓ Temporarily suspended EBL limitation for 2018, 2019 and 2020
  - ✓ Technical Correction – wages not taken into account when determining limitation
- Post-CARES Act
  - ✓ Beginning in 2021, excess business loss limitation will be back in effect

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Qualified Improvement Property

- Technical correction – 39-year property to 15-year property
  - ✓ Retroactively applies to property placed-in-service in 2018
  - ✓ Now eligible for bonus depreciation
- What is considered qualified improvement property?
  - ✓ Internal improvement to **nonresidential** property placed in service after the date the building is first placed into service
  - ✓ Specifically excludes elevators & escalators, internal structural framework and enlargements of the building
- How to correct previously filed tax returns? (Rev. Proc. 2020-25)

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Year-End Tax Considerations

- Ability to carryback NOLs = cash infusion by way of refund claim
- NOLs originating in post-TCJA years not utilized before 2020 will be subject to TCJA rules
- Interplay between NOL & EBL limitation
- Decisions are often taxpayer specific = tax planning

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Deferral of Employment Tax Deposits & Payments

- CARES Act provision provided for deferral of deposit & payment of employer social security taxes
- Payroll Protection Flexibility Act of 2020
  - ✓ Allowed PPP loan recipients who received forgiveness to defer (previously not allowed)
- Applies to deposits of employer's share of SS tax due during the "payroll tax deferral period" and payments imposed on wages paid during that period
- Applicable period = March 27, 2020 through Dec. 31, 2020

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Deferral of Employment Tax Deposits & Payments *(cont'd)*

- When must deferred tax be deposited?
  - ✓ 50% of the deferred amount on Dec. 31, 2021, and
  - ✓ The remaining amount on Dec. 31, 2022
- Cash flow considerations
  - ✓ Must plan for amount due at Dec. 31, 2021

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Deferral of Employment Tax Deposits & Payments *(cont'd)*

- Tax considerations
  - ✓ Delay of deduction and impact on tax liability
  - ✓ Cash Method
    - Deduction allowed in year deposit is made
    - Depending on cash needs & tax situation, consider making deposit before end of 2020 to receive tax deduction
  - ✓ Accrual Method
    - Deduction allowed when "all events test" met and economic performance occurs
    - Recurring item exception

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PPP Loans and Their Tax Treatment

LUCAS RIHELY

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CARES Act text and loan forgiveness

- Forgiveness is excluded from gross income
- Cancellation of debt is usually taxable (or reduces tax attributes) so Congress made a specific exemption for PPP loan forgiveness

PPP Loans and Their Tax Treatment

IRS response

- IRS Notice 2020-32 (released April 30, 2020)
  - ✓ Expenses paid from PPP funds that are ultimately forgiven are non-deductible
  - ✓ Effectively made the PPP loan forgiveness taxable

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PPP Loans and Their Tax Treatment

IRS response *(cont'd)*

- Revenue Ruling 2020-27 (released November 18, 2020)
  - ✓ If the taxpayer reasonably expects to receive forgiveness of the PPP loan, even if the forgiveness is not received until a subsequent tax year, the taxpayer may not deduct the covered expense paid or accrued during 2020.
  - ✓ This is the case whether or not XYZ receives or applies for forgiveness prior to December 31, 2020

Example: XYZ Co received a PPP loan for $500,000 during 2020. XYZ believes it has met all of the requirements of the PPP loan and reasonably expects the loan to be forgiven in full. XYZ closes its books for TY2020 with a loss of $100,000. Assuming no other book-to-tax adjustments, XYZ's taxable income for TY2020 will be $400,000 ($100,000 net loss per books and then adding back $500,000 of non-deductible expenses).

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PPP Loans and Their Tax Treatment

IRS response *(cont'd)*

- Revenue Procedure 2020-51 (released November 18, 2020)
  - ✓ Provides a safe harbor for taxpayers to claim a deduction in TY2020, if:
    - The eligible expenses are paid or incurred during TY2020
    - The taxpayer receives a PPP loan which at the end of TY2020 the taxpayer expects to be forgiven in a subsequent tax year, and
    - In a subsequent year, the taxpayer's request for forgiveness is denied, in whole or in part, or the taxpayer decides never to request forgiveness of the loan

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PPP Loans and Their Tax Treatment

IRS response *(cont'd)*

- Revenue Procedure 2020-51 (released November 18, 2020)
  - ✓ Having met the criteria, the taxpayer may:
    - Deduct these non-deducted expenses on the timely filed, including extensions, original tax return or amended return for TY2020, or
    - Deduct these non-deducted expenses on a timely filed, including extensions, original tax return for the subsequent year in which denial of forgiveness, in whole or in part, is received or when the taxpayer decides not to seek forgiveness.

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PPP Loans and Their Tax Treatment

IRS response *(cont'd)*

- Revenue Procedure 2020-51 (released November 18, 2020)

Example: XYZ Co received a PPP loan for $500,000 during 2020. As of December 31, 2020, XYZ reasonably expected the full amount of the loan to be forgiven and files its TY2020 tax return treating these expenses as non-deductible. XYZ later receives notice that only $450,000 of the PPP loan is forgiven. To claim the $50,000 non-deducted expenses, XYZ may either amend its TY2020 return or deduct the non-deducted expenses on its TY2021 tax return.

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PPP Loans and Their Tax Treatment

Congressional response to IRS

- After IRS Notice 2020-32, Congresspersons expressed frustration with IRS stating it was not the intent of the CARES Act to have these loans be taxable
- Bill S. 3612 introduced in May to make these expenses deductible
- On November 19, 2020, Sens. Grassley and Wyden issued a joint statement urging Treasury to reconsider its position while stating the potential for the fix to be included in end-of-year legislation

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PPP Loans and Their Tax Treatment

Congressional response to IRS *(cont'd)*

- No further congressional action taken to date.
  - ✓ Without action by Congress, current IRS positions are that these expenses are non-deductible, with Revenue rulings and revenue procedures generally considered precedent for taxpayers and the IRS, but are not binding on courts.
  - ✓ AICPA, among other concerned groups, are lobbying Congress to act regarding the deductibility of expenses

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PPP Loans and Their Tax Treatment

Open questions

- To date, Treasury has not addressed a number of open questions regarding certain tax treatment
- Examples
  - ✓ How does the non-deduction of expenses affect Schedule C taxpayers? Those with no payroll had their loans and ultimate forgiveness based solely on net profits.
    - This scenario applies similarly to certain partnerships

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PPP Loans and Their Tax Treatment

Open questions *(cont'd)*

- Examples
  - ✓ Which expenses are considered non-deductible?
    - If the total of the expenses claimed for forgiveness exceed the loan amount, how does the non-deductibility get allocated amongst the various types of expenses? This plays into calculations in other areas of the return
      - ➢ Examples: Qualified Business Income (QBI) deduction or Research & Development (R&D) tax credit calculations
    - In the case of fiscal years ending within the covered period, how are the non-deductible expenses allocated between tax years?

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Open questions *(cont'd)*

- Examples
  - ✓ Which period is the recognition of tax-exempt income appropriate which may affect basis calculations for pass-through entities?
  - ✓ How are these treated for PA income tax purposes?

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Overview of Year-end Tax Planning

BILL BODNAR

Business Solutions, Family Approach

Will normal tax strategies be appropriate in 2020?

- Defer Income
- Accelerate Deductions
- Year-end Charitable Giving
- Harvest Losses

Overview of Year-end Tax Planning

Which 2020 events will impact your decisions?

- The Pandemic
- Enactment of the CARES Act
- Taxable Income Implications from PPP Loans
- Changes in Tax Policy by the New Administration

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How will PPP Loan Forgiveness impact 2020 taxable income?

- Will the Loan Forgiveness Reduce a Taxable Loss?
- Will the PPP Loan Forgiveness Covert a Taxable Loss to Taxable Income?
- Taxpayers Minimally Impacted by the Pandemic May Report Higher Taxable Income

Opportunities presented by the CARES Act

- Five-Year Carryback of NOL’s from 2018 – 2020 Tax Years
- Elimination of the Business Loss Limitation for 2018 – 2020 Tax Years
- Correction of Retail Glitch for Qualified Improvement Property
- Increased Charitable Contribution Limits – Individuals and Corporations
- Minimum Distribution Rules Waived for 2020

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Taxpayers reporting business and taxable losses in 2020

- Will the Expanded NOL Carryback Opportunity Benefit You?
  - ✓ Understand your prior five-year tax reporting history
  - ✓ What effective tax rate did you pay in those prior years?
  - ✓ Consider credit recapture and AMT implications
- Taxpayers May Forgo the Carryback and Elect to Carry Losses Forward

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Taxpayers benefitting from the expanded NOL carryback

- Consider Normal Tax Planning Opportunities to Optimize Loss Carryback and Refund Tax Currently
- Have QIP Deductions Been Claimed (2018 -2020) Tax Years?
- Caution – payment of compensation and acceleration of fixed asset acquisitions to increase deductions could stress cash flow
- Charitable contribution deductions are limited based on taxable income

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Why accelerate income to 2020 and defer expenses?

- Taxpayers Cannot Benefit from Loss Carrybacks – Utilize losses to offset income currently
- Future Increase to Income Tax Rates – especially for corporations and the individual capital gains rates
- Increase in Taxable Income Will Allow for Increased Charitable Contribution Deduction
- Individuals May Benefit From a Roth Conversion – 2020 RMD's Have Been Suspended
- Capital Gains Taxed as low as 0%

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Income acceleration ideas

- Elect out of installment sale treatment
- Forgo Like Kind Exchanges
- Elect Out of Bonus Depreciation
- Exercise Stock Options
- Harvest Capital Gains – Wash Sale Rules Do Not Apply
- Declare Dividends from C Corporations

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Overview of Year-end Tax Planning

Evaluate estimated tax payments

- Utilization of the 2019 Safe Harbor May Result in Overpayment of Taxes
- Prepare Year End Projections With Your Tax Advisor
- Consider Additional Withholding from 2020 Wages if Needed
- Evaluate Your 2020 Payroll Withholdings Now

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Other considerations

- The Kiddie Tax Has Been Reinstated for 2020
- Taxpayers Over 70 ½ With Earned Income May Make a Traditional IRA Contribution
- Unemployment Compensations Received – Is Withholding Adequate?

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Questions / Discussion

THANK YOU

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