2020 Year End Tax Considerations; Corporations and Individual

2020 Year End Tax Saving Ideas. And Considerations Post-Election Biden Tax Policy.

By EOS Accountants LLP

Corporations

As the year end approaches, businesses should be considering ways to minimize corporate income tax and maximize their cash flow. Areas to consider include taking advantage of 2020 legislation such as the CARES Act and SECURE Act which were enacted to get cash in the hands of taxpayers.

The impact of the recent U.S. presidential election results should also be evaluated. Projected winner Joe Biden has included several significant changes to the corporation tax law in his tax agenda which should be considered in any tax planning. This is discussed in further detail below.

Tax Refunds from Net Operating Losses

Companies have experienced a downturn in business due to the Covid-19 pandemic.

The CARES Act allows for Federal net operating losses from tax years 2018, 2019 and 2020 to be carried back to recover taxes paid in the previous 5 years to get refunds. Prior to the CARES Act, the net operating losses could only be carried forward. By allowing corporations to carry back net operating losses to earlier years, the CARES Act provides a double benefit to the corporations. It provides a way to get cash tax refunds quickly, and it also allows for the tax refunds to be obtained at the higher tax rates in place before 2018 (i.e. 34%, 35% rates vs. the current rate of 21%).

Companies that can increase their Federal net operating losses in 2018, 2019 and 2020 can take advantage of the tax rate differential to obtain a larger refund. Ways to increase net operating losses include deferring income recognition until after tax year 2020 or accelerating deductions in tax years 2018, 2019, and 2020.

Ways to increase deductions before year end

<u>**Depreciation**</u>

- The CARES Act fixed a technical problem with bonus depreciation on qualified improvement property (improvements made to the interior portion of an existing building such as replacement of drywall, ceilings, interior doors, fire protection, electrical and plumbing). Such property is now eligible for 100% bonus depreciation. The CARES Act fix is retroactive to 2018 so businesses that placed qualified improvement property in service in 2018 and 2019 can amend those tax years to increase tax depreciation deductions. Alternatively, businesses can take the retroactive deductions on their 2020 tax return.
- Place fixed assets in service before year end - if the corporation is planning on acquiring depreciable fixed assets, the corporation can accelerate the deduction into the current year, by acquiring and placing in service the assets by year end.

Ways to increase deductions before year end

Most fixed assets (except for real property and foreign assets) are eligible for 100% bonus depreciation so that the full cost of the asset can be deducted in the year it is placed in service.

Write-off of worthless debts

Corporations can deduct worthless debts as ordinary deductions (as opposed to capital losses). The timing of when the deduction is taken is dependent on when the debt became worthless. The deduction is only allowed for the tax year in which the debt became worthless. Corporation should evaluate any receivables to determine (1) if any are worthless, and (2) if the receivables became worthless during the year. Receivables which became worthless in 2020, but not discovered to be worthless until later, would not be eligible for deduction in the later year.

Use the Lower cost or market method to write down inventory

The lower of cost or market method of inventory valuation allows corporations to deduct write-downs of inventory before the inventory is sold. The key to establishing the write-down is the determination of "market". Market must be established at the date of the inventory (year-end) through identifying the current bid price (for resale goods) or replacement cost (for manufactured goods). It is advised that you consult with the corporation's auditors as this may impact the corporation's financial accounting.

Method changes to accelerate deductions or defer revenue recognition

Changing the tax method of accounting for deductions and revenue recognition would change the timing of when the deduction is taken or when the revenue is recognized. A change in a tax method of accounting can boost deductions or reduce the taxable revenue in the year the method is changed. This would not affect the financial accounting for these items. Some examples include: Deducting certain prepaid expenses in the year paid. Deducting employee bonuses that are accrued at year end but paid within 2 1/12 months after year end.

While some changes to methods of accounting are considered automatic by the IRS and can be made by the due date of the tax return, other method changes require IRS pre-approval and must be applied for before the end of the year.

Payroll tax deduction

The CARES Act allows for the deferral of an employer's share of the 2020 Social Security taxes with 50% due at the end of 2021 and the remaining 50% due at the end of 2022. While this may provide a cash flow benefit, the employer will generally not be able deduct these deferred taxes in 2020. Consideration can be given to accelerate the timing of the payment of the taxes to increase the deduction in 2020.

Impact of the recent U.S. presidential election

The recent U.S. presidential election should be given careful consideration when examining tax planning ideas. The 2020 election results show that Democrat Joe Biden is projected to be the winner of the presidential election, and the House of Representatives will remain controlled by the Democrats. However, control of the Senate may not be decided until January 2021. The control of the Senate would have a significant impact on the extent of tax law changes that a Biden administration would be able to make. If Republicans maintain control of the Senate, it may be difficult for Biden to get enough support for his tax plans.

Biden's tax plans affecting corporations include increasing the U.S. corporate tax rate from 21% to 28%, imposing a new 15% minimum tax on companies' with book income over $100 million, and increasing the tax rate on U.S. corporations with foreign subsidiaries subject to the global low taxed intangible income (GILTI) tax from 13.125% to 21%, while creating new tax credits to address climate change and promote infrastructure investments in the U.S.

Some of the year-end tax planning ideas discussed above would be different if Biden's tax rate increase were to be enacted. Tax planning steps would be dependent upon whether the corporation is in a taxable income vs. taxable loss position. For example, corporations in a taxable income position may want to defer deductions to the higher Biden tax rate year and accelerate recognition of revenue into the current lower tax rate year. Corporations in a taxable loss position would still want to maximize current year deductions if pre-2018 year taxes are available to be refunded through a net operating loss carryback.

Other Tax Considerations

In addition to year-end tax planning, there are several other tax related items to be aware of.

Transfer pricing

While in past years, a corporation's transfer pricing on cross-border transactions with related parties may have been "within the range" to avoid adjustments by the IRS, with the impact of the Covid-19 pandemic, business operations and profits may have significantly changed. Corporations with cross-border related party transactions should take a fresh look at transfer pricing. New full transfer pricing documentation studies may be needed to be able to demonstrate that the pricing still meets the arm's length standard.

Filing Net Operating Loss Carryback Claims by December 31

Corporations can use Form 1139, Application for Tentative Refund, to apply for refunds resulting from the carryback of 2018 and 2019 net operating losses. For calendar year corporations, Form 1139 needs to be filed by December 31, 2020 to carryback NOL generated in 2019. Additionally, due to the backlog of mail at the IRS, a fax number is available at the IRS to expedite the processing of the Form 1139. This fax number is only available until December 31, 2020. If Form 1139 is not filed by December 31, then the corporation must claim the refunds by carrying back the net operating losses by filing amended returns, Form 1120X, which take much longer for the IRS to process. It should be noted that unused Minimum Tax Credits, either existing or newly generated due to a net operating loss carryback, can also be quickly refunded by filing Form 1139. The deadline for filing Form 1139 to refund these credits is December 31, 2020.

NOTE

Fax # 844-249-6237 is only available until midnight (EST) Dec. 31, 2020.

Obtain quick refunds of overpaid 2020 estimated tax

After year end, but before the original due date of the return (April 15 for calendar year corporations), a corporation can apply to quickly receive overpaid estimated taxes by filing Form 4466, Corporation Application for Quick Refund of Overpayment of Estimated Tax. The IRS will refund the overpayment within 45 days from when the form is filed. This is an easy way to have overpaid estimated tax payments refunded before the filing of the tax return.

Other Tax Considerations

Telework issues

With many employees working from home due to the Covid-19 pandemic, state tax issues around employment tax and income tax nexus can become an issue when the employee is teleworking from a state that is different from the employee's normal work location. Corporations should be aware that a change of where the employee is working can change where the employment taxes are owed. Also, corporations may have corporate tax nexus in states where the corporation may not have previously been filing returns. States have generally provided some flexibility during the pandemic. But as we move past the initial stay at home orders, and with teleworking being more common even when employees can return to their work locations, states are likely to go back to the pre-pandemic rules for determining taxability in the state. It is important that corporations carefully track their employees' teleworking locations.

State tax considerations

Due to the Covid-19 pandemic, states are experiencing revenue shortfalls and unprecedented emergency spending. States will likely be implementing measures to increase tax such as suspending the use of net operating loss deductions.

Conclusion

In these economic times, it is worthwhile to examine your tax situation and to consider any tax-saving opportunities. EOS Accountants LLP is available to assist you.

Individual

As the year end approaches, Individuals should be considering income tax planning opportunities. Areas to consider include taking advantage of 2020 legislation such as the CARES Act and SECURE Act which were enacted to get cash in the hands of taxpayers.

2020 Year-End Tax planning

Below are some individual tax updates for 2020 tax year.

- Under the CARES ACT, individuals who don't itemize can deduct cash charitable contribution to public charities up to $300 from the gross income.
- Individuals can deduct cash donation up to 100% of the adjusted gross income on itemized deduction. This was increase from 60% cap last year.
- The threshold for itemized medical deduction for 2020 is 7.5% of adjusted gross income.
- The tuition and fees deduction up to $4,000 for qualified higher education cost is available for 2020. This deduction expired at the end of 2017 but was extended for 2018 to 2020.

Biden's individual Tax Proposal

Democratic presidential candidate Joe Biden is projected to have won the race, but control of the Senate may not be decided until January 2021. The results of the 2020 elections for the White House and Congress will have a significant impact on the direction of tax policy over the next four years. Below are proposed individual tax plans by Biden during his campaign although the prospect of significant tax changes remain unclear.

Biden promised no tax increase for individuals with income under $400,000 and tax increases are focused on the wealthy individuals. Target areas for wealthy individuals are as follows;

<u>Individual income tax rate</u>

Raising the top income tax rate to 39.6% for those individuals with income above $400,000.

Pre-TCJA (Pre-Tax Cut and Jobs Act) rates above $400,000 of taxable income will be restored and top tax rate will be increased from current 37% to 39.6% for income over $400,000.

Biden's individual Tax Proposal

Capital gain tax rate

Increasing the capital gains tax rate to 39.6% for individuals with income above $1 million.

Tax on capital gains and qualified dividends of high-income individuals whose income exceeds $1 million will be taxed at ordinary tax rates, 39.6%. It will be a significant increase from current tax rate of 20%.

Payroll Tax

Imposing OASDI payroll tax on income above $400,000. Payroll taxes currently only apply to the first $137,700 of an individual's income.

Individuals earning $400,000 or more would pay additional payroll taxes. Biden plan would impose an additional Social Security payroll tax of 6.2% on all earned income of $400,000 or more. Under the plan, no additional Social Security tax would be imposed on wages between the wage base, currently $137,700, up to $400,000.

Limitation on Itemized deduction

Biden plan also has proposed to cap the value of itemized deductions at 28% for individuals earning more than $400,000. It also reinstates a phase-out of deduction for high income individuals

Enhancement of tax credits

Biden also proposes the list of enhanced tax credit.

- Temporarily increase child tax credit from current $2,000 to $3,000 ($3,600 for children under 6) and make it refundable
- The maximum Child and Dependent Care Credit would increase from $3,000 for one person to $8,000 ($16,000 for more than one dependent) and make it refundable
- $15,000 refundable tax credit for first time homebuyers

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