



BUSINESS TAX PLANNING

As the year draws to a close, we should review your business's projected taxable income or loss to see what last minute actions might be appropriate before year end to reduce taxes. It's also important to ascertain whether enough estimated taxes have been paid to avoid any underpayment of estimated tax penalties.

Section 179 Expensing and Bonus Depreciation

Two of the biggest tax incentives available to any business are the Section 179 expense election and the bonus depreciation deductions; these are not an either/or proposition. You may be eligible for both, depending on the amount of the business's taxable income. These deductions can significantly lower your taxable income, thus saving a bundle on federal and state income taxes. Whether any last-minute purchases before the end of the year are advisable will depend not only on the business needs but whether the extra deductions available can be utilized in 2019.

Under the Section 179 expensing option, you can immediately expense the cost of up to \$1,020,000 of "Section 179" property placed in service in 2019. This amount is reduced dollar for dollar (but not below zero) by the amount by which the cost of the Section 179 property placed in service during the year exceeds \$2,550,000. The Section 179 deduction is also limited to your aggregate taxable income for the year derived from the active conduct of a trade or business. Thus, unlike depreciation, the Section 179 expense cannot be used to reduce income below zero. This expensing option is available to individuals, S corporations, C corporations, and partnerships. It's important to note that, to be considered Section 179 property, the property must meet certain eligibility requirements, be acquired for business use, and be acquired by purchase. In addition, certain limitations apply to the expensing of passenger automobiles and sport utility vehicles.

In addition to the Section 179 expense option, an additional first-year depreciation allowance, known as "bonus" depreciation, is available for qualifying property placed in service in 2019. Generally, unless you elect out of the bonus depreciation deduction, 100 percent of the cost of qualifying property, which is not expensed under Section 179, must be deducted. This applies to new or used trade or business property. The property must meet an "original use" or "used acquisition" requirement. A deduction is still available even if you use the property for personal purposes, as long as your business use is more than 50 percent. However, if your business use of the property falls to 50 percent or less, you may have to recapture the earlier deductions as income. Unlike with the Section 179 deduction, there is no taxable income limitation on a deduction for bonus depreciation.

The purchase of a business vehicle could result in a substantial tax benefit. If your business needs a large passenger vehicle, consideration should be given to purchasing a sport utility



vehicle with a gross vehicle weight ("GVW") more than 6,000 pounds. Vehicles under that GVW limit are considered listed property and deductions are limited to \$18,100 for cars, trucks

and vans acquired and placed in service in 2019. However, if the vehicle is more than 6,000 pounds, up to \$25,500 of the cost of the vehicle can be immediately expensed.

Qualified Improvement Property Glitch Remains Unfixed

Congress did not enact any significant business tax legislation this year. As a result, it did not fix a glitch in the Tax Cuts and Jobs Act of 2017 (TCJA) that prevents the depreciation of qualified improvement property over the 15-year life that such property was eligible for prior to 2018. Where such property is placed in service after 2017, it is still generally subject to a 39-year depreciation life and, thus, not eligible for bonus depreciation.

Qualified Business Income Deduction

Another potentially big deduction, the qualified business income deduction ("QBI"), remains available to sole proprietors, partners in a partnership, members of an LLC taxed as a partnership, or S corporation shareholders. Trusts and estates may also be eligible for this deduction.

While the rules relating to the QBI deduction can be complex, the amount of the deduction is generally 20 percent of qualifying business income from a qualified trade or business. A qualified trade or business means any trade or business other than:

- (1) A specified service trade or business
- (2) The trade or business of being an employee

A specified service trade or business is defined as any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, including investing and investment management, trading, or dealing in securities, partnership interests, or commodities, and any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees. Engineering and architecture services are specifically excluded from the definition of a specified service trade or business.

However, a special rule allows you to take this deduction even if you have a specified service trade or business. Under that rule, the provision disqualifying such businesses from being considered a qualified trade or business for purposes of the qualified business income deduction does not apply to individuals with taxable income of less than \$160,700 (single), \$160,725 (married filing separately), and \$321,400 (joint filers). After an individual reaches the threshold amount, the restriction is phased in over a range of \$50,000 in taxable income (\$100,000 for joint filers). Thus, if your income falls within the applicable range, you are allowed

a partial deduction. Once the end of the range is reached, the deduction is completely disallowed.

For purposes of the deduction, items are treated as qualified items of income, gain, deduction, and loss only to the extent they are effectively connected with the conduct of a trade or business within the United States. In calculating the deduction, qualified business income means the net amount of qualified items of income, gain, deduction, and loss with respect to the qualified trade or business of the taxpayer.

Rental Real Estate

Rental real estate enterprises operated by individuals and owners of pass-through entities may also qualify for the qualified business income deduction if certain criteria are met. For example, a taxpayer's rental activity must be considerable, regular, and continuous in scope. In determining whether a rental real estate activity meets this criteria, relevant factors include, but are not limited to, the following:

- (1) The type of rented property (commercial real property versus residential property)
- (2) The number of properties rented
- (3) The taxpayer's or taxpayer's agent's day-to-day involvement
- (4) The types and significance of any ancillary services provided under the lease
- (5) The terms of the lease (for example, a net lease versus a traditional lease and a short-term lease versus a long-term lease)

Under a safe harbor issued by the IRS, a rental real estate activity will be treated as a business eligible for the special deduction if certain requirements are satisfied, such as:

- (1) Separate books and records are maintained to reflect the income and expenses for each rental real estate enterprise
- (2) For rental real estate enterprises that have been in existence less than four years, 250 or more hours of rental services are performed per year with respect to the rental real estate enterprise (with slightly less stringent requirements for rental real estate enterprises that have been in existence for at least four years)
- (3) Contemporaneous records have been maintained, including time reports, logs, or similar documents, regarding the following:
 - a. Hours of all services performed
 - b. Description of all services performed
 - c. Dates on which such services were performed
 - d. Who performed the services
- (4) Certain compliance requirements are met

Thus, to qualify for this deduction, it's important to determine if the safe harbor conditions are met and, if not, whether such conditions can be met by year end. Alternatively, even if the safe



harbor requirements are not met, certain actions may be taken to ensure that your real estate business falls within the "trade or business" guidelines for taking the deduction.

Finally, whether a rental real estate enterprise is considered a passive activity with respect to a taxpayer is important in determining whether losses from the activity are deductible. Generally, passive activity losses are only deductible against passive activity income. However, a deduction of up to \$25,000 (\$12,500 if married filing separately) may be allowed against non-passive income to the extent an individual actively participates in the rental real estate activities. However, the deduction is subject to a phase out for individuals with modified adjusted gross income above \$100,000 (or \$50,000 if married filing separately).

Vehicle-Related Deductions and Substantiation Requirements

Expenses relating to business vehicles can add up to major deductions. If your business could use a large passenger vehicle, consider purchasing a sport utility vehicle weighing more than 6,000 pounds. If the vehicle is more than 6,000 pounds, up to \$25,500 of the cost of the vehicle can be immediately expensed.

The TCJA has increased the amount of depreciation that can be taken per vehicle. If the vehicle is placed into service in 2019, the allowable depreciation will be: \$10,000 for the first year, \$16,000 for the second, \$9,600 for the third and \$5,760 or any subsequent years. The TCJA retained the \$8,000 limit for additional first-year depreciation for passenger automobiles, so the maximum amount a taxpayer can deduct for a passenger vehicle in the first year is \$18,000 (plus the additional \$25,000 for vehicles over 6,000 pounds for a total of \$43,000 in the first year).

There is an additional credit for plug-in electric drive vehicles up to \$7,500. The original use of the vehicle must commence with the taxpayer and the vehicle must be used predominantly in the United States.

Vehicle expense deductions are generally calculated using one of two methods: the standard mileage rate method or the actual expense method. If the standard mileage rate is used, parking fees and tolls incurred for business purposes can be added to the total amount calculated, as well as any interest paid for financing.

Since the IRS tends to focus on vehicle expenses in an audit and disallow them if they are not properly substantiated, you should ensure that the following are part of your business's tax records with respect to each vehicle used in the business:

- (1) The amount of each separate expense with respect to the vehicle (e.g., the cost of purchase or lease, the cost of repairs and maintenance, etc.)
- (2) The amount of mileage for each business or investment use and the total miles for the tax period
- (3) The date of the expenditure



(4) The business purpose for the expenditure

The following are considered adequate for substantiating such expenses:

- (1) Records such as a notebook, diary, log, statement of expense, or trip sheets
- (2) Documentary evidence such as receipts, canceled checks, bills, or similar evidence

Records are considered adequate to substantiate the element of a vehicle expense only if they are prepared or maintained in such a manner that each recording of an element of the expense is made at or near the time the expense is incurred.

Fringe Benefit/Retirement Programs

Providing fringe benefit and retirement programs to employees is a good way to attract and retain talented workers. Many businesses use benefits rather than higher wages to entice future employees. While your business is not required to have a retirement plan, there are many advantages to having one. By starting a retirement savings plan, you not only help your employees save for the future, you can also use such a plan to attract and retain qualified employees. Retaining employees longer can impact your bottom line by reducing training costs and search costs. In addition, as a business owner, you can take advantage of the plan yourself, and so can your spouse. If your spouse is not currently on the payroll, you may want to consider adding them as an employee and paying a salary up to the maximum amount that can be deferred into a retirement plan. So, for example, if your spouse is 50 years old or over and receives a salary of \$25,000, all of it could go into a 401(k), leaving your spouse with a retirement account but no taxable income.

The amount of contributions varies depending on the type of plan the business has implemented. Some common limits are 401(k)/403(b) limit have increased to \$19,000 if under 50 years old, \$25,000 if over 50 years old; SIMPLE limit remained at \$13,000 if under 50 years old, \$16,000 if over 50 years old. Please contact us if you would like to confirm that you will maximize the funding of your retirement plans for 2019. Also, let us know if you would like to review your current retirement plan and evaluate other options.

By offering a retirement plan, you also generate tax savings to your business because employer contributions are deductible and the assets in the retirement plan grow tax free. Additionally, a tax credit is available to certain small employers for the costs of starting a retirement plan. Please let me know if this is an option you would like to discuss further.

Increasing Basis in Pass-thru Entities

If you are a partner in a partnership or a shareholder in an S corporation, and the entity is passing through a loss for the year, you must have enough "basis" in the entity in order to deduct the loss on the personal tax return. If you don't, and if you can afford to, please consider



increasing your basis in the entity, for example by making a capital contribution, in order to take the loss in 2019.

Electing the De Minimis Safe Harbor

It may be advantageous to elect the annual de minimis safe harbor election for amounts paid to acquire or produce tangible property. By making this election, and as long as the items purchased don't have to be capitalized under the uniform capitalization rules and are expensed for financial accounting purposes or in your books and records, you can deduct up to \$2,500 per invoice or item (or up to \$5,000 if you have an applicable financial statement).

S Corporation Shareholder Salaries

For any business operating as an S corporation, it's important to ensure that shareholders involved in running the business are paid an amount that is commensurate with their workload. The IRS scrutinizes S corporations which distribute profits instead of paying compensation subject to employment taxes. Failing to pay arm's length salaries can lead not only to tax deficiencies, but penalties and interest on those deficiencies as well. The key to establishing reasonable compensation is being able to show that the compensation paid for the type of work an owner-employee does for the S corporation is similar to what other corporations would pay for similar work. If you are in this situation, we need to document the factors that support the salary you are being paid.

Update QuickBooks/Sage/Zero or Other Accounting Software

Now would be a good opportunity to review your QuickBooks records or other accounting software to see if there are any outstanding bookkeeping issues that need to be dealt with before the end of the year; such as bank reconciliations, payroll reconciliations, new asset purchases, recording new loans, adding last year's adjusted journal entries, and adjusting Accounts Receivable and Accounts Payable. It's a lot easier on all of us if these issues are dealt with before the rush of tax season deadlines.

Corporate Tax Rate and Dividend Received Deduction

The TCJA eliminated the graduated corporate tax rate structure in favor of a flat rate of 21% for corporate taxable income. Also eliminated is the special tax rate for personal service corporations.

Dividend received deduction available to corporations that receive a dividend from another taxable domestic corporation has been reduced from 70% to 50%. The TCJA also reduces dividends received deduction of a 20% ownership from 80% to 65%.



Corporate Alternative Minimum Tax ("AMT")

The TCJA repeals the corporate AMT. The provision allows the AMT credit to offset the regular tax liability for any taxable year. In addition, the AMT credit is refundable for any taxable year between now and 2021 in an amount equal to 50% of the excess of the minimum tax credit for the taxable year over the amount of the credit allowable for the year against regular tax liability.

Revenue and Expense Timing

If you are a cash basis taxpayer, the revenue and expenses reported on your tax returns are recorded when they are received and paid. The timing of when you receive payments from customers and make payments to vendors can greatly alter the amount of revenue and expenses your business is required to report. Please contact us if you are considering shifting your income to reduce your flow-through income.

Net Operating Loss ("NOL") Carryforward/Carryback

Under TCJA, excess business losses of a taxpayer other than a corporation are not allowed for the taxable year. Such losses are carried forward and treated as part of your NOL future years (the 2-year NOL carryback is no longer permissible). The new provision increased the 20 year carryforward limit to an indefinite amount of time. The amount of the carryforward is limited to 80 percent of your taxable income prior to the NOL deduction. NOL's from prior years will be grandfathered in and the income limitation will apply.

Children Working In Business

Children working in closely-held businesses can offer a tax planning opportunity and potentially be targeted toward educational planning. The wages paid to children working in your closely-held business are tax deductible. The amount of compensation must be reasonable. Children can earn approximately \$12,200 without paying Federal individual income taxes because of the increased standard deduction amount; Virginia allows \$11,950 in gross income before any tax is due. This would allow your children to supplement educational planning without incurring additional income tax liability. The business would benefit from the deduction of the wages paid to your children. If you have school-aged children working in your business, please let us know so we can help you determine if they should be added to the payroll.

Credits

Business credits are available for certain energy efficiency improvements; disabled access improvements, and adding certain employees under the work opportunity credits. Please let us know if you have made access improvements to your facilities and/or equipment, completed any



energy efficiency upgrades, or added to your staff with any workers from certain veteran/disadvantaged groups.

Qualified Equity and Subordinated Debt Investments Credit

Individual and fiduciary taxpayers are allowed a credit up to 50% of qualified business investments in the form of equity or subordinated debt of a pre-qualified business venture. This could be a good way to incentivize investors for your business.

In order for the taxpayer to claim the credit your business would first have to file Form QBA with the Virginia Department of Taxation by December 31st of the year that you request the qualification. Once you have submitted Form QBA, the investor would have to file Form EDC by April 1st of the year following the investment to apply for the credit.

It should be noted that an investment will not qualify if the taxpayer who holds the investment, any of the taxpayer's family members, or entities affiliated with the taxpayer receives compensation from the qualified business for services provided. This would include employees, officers, directors, managers, or independent contractors within one year before/after the date of the investment.

If you believe that this credit could be advantageous to your business please call office so that we can discuss in detail if you will qualify for credit.

Increase Penalties for Failure to Timely File Information Returns

In addition to the accelerated filing deadlines for 2019 Forms W-2, Forms W-3, and Forms 1099-MISC, higher penalties apply for

- (1) the failure to file correct Forms W-2 by the due date
- (2) the intentional disregard of filing requirements
- (3) the failure to furnish Forms W-2
- (4) the intentional disregard of payee statement requirements

In addition to applying to Forms W-2, W-3, and 1099-MISC, other common forms subject to these increased penalties include: Schedules K-1 for Forms 1041, 1065, and 1120S. Penalties for the late filing of these information returns have also increased. For each information return or payee statement with respect to which a failure occurs, the penalty has been increased from \$250 to \$260, and the maximum penalty that may be imposed has been increased from \$3,000,000 to \$3,178,500. The per-failure penalty for intentionally disregard the filing requirements also has been increased, from \$520 to \$540.



Changes Made to Tax Return Due Dates

In general, C-Corporations with tax years ending in 2019 now have an extra month to file their federal income tax returns. Such returns are due by the 15th day of the fourth month following the close of the tax year, rather than the 15th day of the third month following the close of the tax year. Thus, 2019 calendar-year C-corporation federal income tax returns are due April 16, 2020. A special rule exempts C-corporations with fiscal years ending on June 30th from this change until tax years beginning after December 31, 2025. Thus, the filing deadline for such corporations remains September 15th until 2026 (when it will change to October 15th).

Partnerships with tax years ending in 2019 are now required to file their federal income tax returns by the 15th day of the third month following the close of the tax year, rather than the 15th day of the fourth month following the close of the tax year. Thus, 2019 calendar-year partnership federal income tax returns are due March 16, 2020, due to the 15th falling on a weekend.

While partnerships were previously allowed a five-month extension of time in which to file their tax returns, they are now allowed a six-month extension so that the extended due date is the same as under prior law (i.e. September 15th).

The filing deadline for S-Corporation returns remains unchanged, meaning that partnerships and S corporations will now share the same due dates.

All business returns that go on extension will be due September 15, 2020.

Increasing Basis in Pass-Thru Entities

If you are a partner in a partnership or a shareholder in an S- corporation, and the entity is passing through a loss for the year, you must have enough basis in the entity in order to deduct the loss on your personal tax return. If you don't, and if you can afford to, you should consider increasing your basis in the entity in order to take the loss in 2019.

Meals and Entertainment

Under TCJA, you will no longer be able to deduct expenses related to entertainment, amusement, or recreation. This includes any membership dues of clubs organized for business, recreation/social purposes, or any facility used in connection with aforementioned items.

You will be allowed to deduct 50 percent of food and beverage expenses that are business related. The TCJA has expanded the meals deduction to include 100 percent of expenses by the employer associated with providing food or beverages to employees for the convenience of the employer. Simply put you are allowed to deduct on-sight "working lunch/dinners".



Miscellaneous Tax Considerations

Other considerations for 2019 include the following:

- (1) The 100 percent exclusion from gross income of gain from the sale of small business stock
- (2) The reduction to five years of the recognition period for the built-in gains of S-corporations
- (3) The deduction for charitable deductions of food inventory by taxpayers other than C-corporations
- (4) The expensing allowance for certain film and television productions and the cost of live theatrical productions
- (5) The deduction for income attributable to domestic production activities in Puerto Rico
- (6) Tax rules relating to payments between controlled foreign corporations and dividends of regulated investment companies
- (7) The basis adjustment rule for stock of an S-Corporation making charitable contributions of property
- (8) Tax incentives for investment in empowerment zones

Let us know if you have any questions, or if you require any clarification of any of these subjects. We wish you a successful conclusion to the year and a Happy New Year!