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2023 YEAR-END INCOME TAX PLANNING FOR BUSINESSES

INTRODUCTION

As we approach the beginning of a new year, it's important to review 2023 for possible tax planning opportunities for your business. We believe a review of your 2023 tax situation could lead to tax savings when you file next year. To assist in your review, we've included our 2023 year-end income tax planning letter for businesses. In this letter, you will find selected traditional and new planning ideas for you to consider. Of course, if you have any questions or want to discuss planning ideas not included in our letter, please call our firm.

Caution! The IRS continues releasing guidance on various important tax provisions. We closely monitor new tax legislation and IRS releases. Please call our firm if you would like an update on the latest tax legislation, IRS notifications, announcements, and guidance or **if you need additional information concerning any item discussed in this letter.**

Be careful! Although this letter contains planning ideas, you cannot properly evaluate a particular planning strategy without calculating the overall tax liability for the business and its owners (including the alternative minimum tax) with and without the strategy. In addition, this letter contains ideas for Federal income tax planning only. **State income tax issues are not addressed.** However, you should consider the state income tax impact of a particular planning strategy. We recommend that **you call our firm before implementing any tax planning technique** discussed in this letter.

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POSSIBLE LEGISLATION BEFORE YEAR-END

Each year we work to provide you with our year-end planning letter in time to implement possible tax saving strategies before December 31st. As a result, it's possible Congress could pass new legislation between your receipt of this letter and year-end. However, as of the completion of this letter, it appears an omnibus spending package is the best chance for any provisions that may affect your 2023 tax return. Please **contact our firm** if you'd like an update on current legislation and how it could affect your business.

HIGHLIGHTS OF PROVISIONS INCLUDED IN SECURE ACT 2.0 FIRST EFFECTIVE AFTER 12/29/22 (DATE OF ENACTMENT) OR AFTER 12/31/22

On Thursday, December 29, 2022, the President signed H.R. 2617, the "Consolidated Appropriations Act, 2023," providing appropriations for the Federal government's fiscal year ending September 30, 2023. In the following summary, we've listed a few provisions of the Secure Act 2.0 (SECURE 2.0) segment of the Consolidated Appropriations Act, 2023.

First Year Elective Deferral For Sole Proprietor Who Is Only Participant In 401(k) Plan May Be Made By Initial Due Date Of Return

- **Background.** If an employer adopts a stock bonus, pension, profit-sharing, or annuity plan after the close of a taxable year but before the due date of the tax return for the taxable year (including extensions), the **employer may elect to treat the plan as having been adopted as of the last day of the taxable year.** However, participants in a 401(k) plan were not able to make elective deferral contributions to such plans for that first plan year if the plan was established after the end of the taxable year.

- **SECURE 2.0 Defers Date For Elective Deferral By Qualifying Sole Proprietor For First Plan Year Until Original Due Date Of Return.** SECURE 2.0 provides that an individual who **owns the entire interest in an unincorporated trade or business and who is the only employee of such trade or business,** may make elective contributions to the business's 401(k) plan on or before the due date **(excluding extensions)** of the owner's tax return for the tax year ending after or with the end of the plan's first plan year. Such elective deferrals are deemed made before the end of the first plan year. **This provision only applies to the plan year in which the plan is established. Caution!** This provision only applies to plans established by sole proprietors where the proprietor has no employees.

Summary Of Selected Other Changes Made To Retirement Plans By SECURE 2.0

The following is a brief summary of selected provisions of SECURE 2.0 first effective for 2023. **Caution!** A business wishing to implement any of these provisions should consult with the attorney handling the business's qualified plan since these provisions may require plan amendments.

- **Qualified Retirement Plans, §403(b) Plans, And §457(b) Plans May Permit Participants To Designate Employer Matching Contributions Or Nonelective Employer Contributions As Designated Roth Contributions After 12/29/22.**

- **SIMPLE Plans And SEP Plans May Allow Employees To Make Roth Contributions For Taxable Years Beginning After 2022.**

- **For Tax Years Beginning After 2022 SECURE 2.0 Provides An Up To 100% Credit For Plan Startup Costs For Employers With 50 Or Fewer Employees.** As under prior law, the credit is up to 50% of the plan startup costs where the number of employees is more than 50 but not more than 100. **Startup costs** are expenses connected with **establishment or administration** of the plan or with retirement-related education **for employees** with respect to the plan. The credit is available for the first three years of the plan. SECURE 2.0 also provides an additional credit of up to $1,000 of employer

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contributions for each employee. The full $1,000 per employee credit only applies to employers with 50 or fewer employees.

- **<u>New Credit For Military Spouse's Participating In Employer's Plan For Employers With 100 Or Fewer Employees For Preceding Year.</u>** For each of the first three years of a military spouse's participation, the credit is: **1)** $200 <u>plus</u> **2)** up to $300 of employer's contributions to the plan for the military spouse (other than elective deferrals).

<u>OTHER SELECTED RECENT DEVELOPMENTS</u>

<u>IRS Suspends Processing ERC Claims Received On Or After September 14, 2023.</u> Every day there are numerous TV ads, radio ads, emails and other solicitations from promoters wanting to help business owners of all sizes obtain the Employee Retention Credit (ERC). In a September 14, 2023 article, the Wall Street Journal reported that the IRS has received 3.6 million ERC claims. The IRS also says it is still receiving 50,000 claims each week, more than twice the average volume since March 2020. As of March 2023, the Journal says the IRS had paid more than $150 billion in ERC claims. Treasury data suggests the figure is now $230 billion, or roughly triple the original congressional estimates.

The IRS has warned employers to be aware of organizations offering to help them claim the Employee Retention Credit when they may not actually qualify. The IRS said in the warning "*Some third parties are taking improper positions related to taxpayer eligibility for and computation of the credit. These third parties often charge large upfront fees or a fee that is contingent on the amount of the refund and may not inform taxpayers that wage deductions claimed on the business' federal income tax return must be reduced by the amount of the credit.*"

As a result, on September 14 of this year the IRS released the following statement: *"Amid rising concerns about a flood of improper Employee Retention Credit claims, the Internal Revenue Service today announced an immediate moratorium through at least the end of the year on processing **new claims** for the pandemic-era relief program to protect honest small business owners from scams. IRS Commissioner Danny Werfel ordered the immediate moratorium, beginning today, to run through at least Dec. 31 following growing concerns inside the tax agency, from tax professionals as well as media reports that a substantial share of new claims from the aging program are ineligible and increasingly putting businesses at financial risk by being pressured and scammed by aggressive promoters and marketing."* [Emphasis added]

The IRS says payouts for ERC claims received *before* September 14 will continue during the moratorium period but at a slower pace. IRS says, *"With the stricter compliance reviews in place during this period, existing ERC claims will go from a standard processing goal of 90 days to 180 days – and much longer if the claim faces further review or audit. The IRS may also seek additional documentation from the taxpayer to ensure it is a legitimate claim. * * **

The IRS is increasingly alarmed about honest small business owners being scammed by unscrupulous actors, and we could no longer tolerate growing evidence of questionable claims pouring in, Werfel said. 'The further we get from the pandemic, the further we see the good intentions of this important program abused. The continued aggressive marketing of these schemes is harming well-meaning businesses and delaying the payment of legitimate claims, which makes it harder to run the rest of the tax system. This harms all taxpayers, not just ERC applicants.'"

The IRS said it would provide a special procedure to withdraw unpaid ERC claims for those who have filed an ERC claim, but the claim has not been processed. **This option will allow the taxpayers to avoid possible repayment issues.** The IRS says, ***"Under any scenario, if** a business claimed the ERC earlier and **the claim has not been processed or paid by the IRS, they can withdraw the claim if they now believe it was submitted improperly – even if their case is already under audit or awaiting audit."*** [Emphasis added]

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IRS Outlines ERC Refund Claim Withdrawal Option. The IRS has now outlined details of a repayment option at its website. IRS *says "Claims that are withdrawn will be treated as if they were never filed. The IRS will not impose penalties or interest."* IRS also suggests taxpayers *"Work with a* trusted tax professional *if you need help or advice on this process or on the ERC*."

Details, generally in the form of FAQs are available here – Withdraw an Employee Retention Credit (ERC) claim | Internal Revenue Service (irs.gov). These withdrawal procedures generally allow ERC claims to be withdrawn where the claim was made on an amended payroll tax return and either the IRS has not paid the claim or it has paid the claim, but the taxpayer has not cashed the check.

Extension For Filing Returns And Making Certain Payments Until February 15, 2024 For Taxpayers Living In Or Doing Business In Disaster Areas. The IRS has announced that individuals living in, and businesses located in the counties designated as "covered disaster areas" in Florida, South Carolina, and Georgia because of Hurricane Idalia now have until February 15, 2024, to file returns and to make certain payments **due during the period beginning August 27, 2023, for Florida, August 29, 2023, for South Carolina, and August 30, 2023, for Georgia, and ending February 15, 2024.** If you live or have a businesses located in FL, SC or GA, please go to the following website https://www.irs.gov/newsroom/tax-relief-in-disaster-situations for more information. This website also provides a **listing of all federal disaster areas for 2023 and the due date for returns of taxpayers located in those disaster areas.** Please consult this website if there has been a major disaster in your area to find the extended return due dates.

- **Examples Of Returns And Payments Receiving An Extension Until February 15, 2024.**

  a. Estimated income tax payments, normally due on September 15, 2023, and January 16, 2024, and other estimated income tax payments otherwise due between August 27, 2023 (FL), August 29, 2023 (SC), or August 30, 2023 (GA) and before February 15, 2024.

  b. Business returns with an original or extended due date occurring on or after August 27, 2023 (FL), August 29, 2023 (SC), or August 30, 2023 (GA) and before February 15, 2024. This includes, among others, calendar-year partnerships and S corporations whose 2022 extensions ran out on September 15, 2023, and calendar-year corporations whose 2022 extensions ran out on October 16, 2023.

  c. Quarterly payroll and excise tax returns normally due on October 31, 2023, and January 31, 2024.

  d. Estate and trust income tax returns; estate, gift, and generation-skipping transfer tax returns; and annual information returns of tax-exempt organizations that have either an original or extended due date occurring on or after August 27, 2023 (FL), August 29, 2023 (SC), or August 30, 2023 (GA) and before February 15, 2024.

- **Payment Of Payroll And Excise Tax Deposits.** Penalties on payroll and excise tax deposits due on or after August 27, 2023 (FL), August 29, 2023 (SC) or August 30, 2023 (GA) and before September 11, 2023 (FL), September 13, 2023 (SC), or September 14, 2023 (GA) will be abated as long as the tax deposits were made by September 11, 2023, September 13, 2023, or September 14, 2023.

- **Generally, No Extended Time For Filing W-2s And Certain Other Information Returns.** The IRS says unless an act is specifically listed in Rev Proc 2018-58, the postponement of time to file and pay does not apply to information returns in the W-2, 1094, 1095, 1097, 1098 or 1099 series; or to Forms 1042-S, 3921, 3922 or 8027.

The Inflation Reduction Act Of 2022. On August 16, 2022, President Biden signed the Inflation Reduction Act of 2022 (IRA). The IRA, among other things, extends and creates various energy provisions for businesses and introduces: **1)** a 15% alternative minimum tax (AMT) and **2)** a 1% excise tax on stock redemptions both of which apply to certain publicly traded corporations beginning in 2023. The following are a few of the changes made by the Inflation Reduction Act which may affect your year-end planning. If you would like more details about the Inflation Reduction Act of 2022, please **call our firm.**

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- **<u>"New Clean Vehicle Credit" For Vehicles Placed In Service After 2022 And Before 2033.</u>** Taxpayers may qualify for a credit of up to $7,500 for taking possession of a qualified new electric vehicle during 2023. This credit is available for vehicles used in a business (i.e., depreciable vehicles) and for vehicles acquired for personal use. However, more businesses should qualify for the credit for commercial vehicles discussed in the next paragraph than for this credit. To qualify for the New Clean Vehicle Credit, the vehicle must be a qualified electric vehicle (EV) or a qualified fuel cell vehicle. The taxpayer must be the first user of the vehicle after the vehicle is sold, registered, or titled. **No credit is allowed for a new vehicle if the manufacturer's suggested retail price of the vehicle exceeds: $80,000** for SUVs, pickups, and vans; and **$55,000** for other vehicles. In addition, **no credit** will be allowed for a new vehicle **if the lesser of current or prior year modified adjusted gross income of the taxpayer is more than $300,000 for joint filers, $225,000 for head of households, and $150,000 for others.** In addition, final assembly of the vehicle must occur in North America. **<u>Note!</u>** The retail price limitations, the modified adjusted gross income limitations, and the requirement that final assembly of the vehicle must occur in North America do not apply to commercial vehicles discussed below.

  The requirements for a vehicle to qualify for the credit are different for vehicles placed in service before April 18, 2023, and those placed in service after April 17, 2023. The IRS says a taxpayer places and EV in service when the taxpayer takes possession of the vehicle. Because of the complexity for determining whether a vehicle qualifies for the credit and determining the amount of the credit, we suggest using the IRS website to determine whether an EV acquired during 2023 qualifies for the new clean vehicle credit and the amount of the credit. The relevant web address is <u>Federal Tax Credits for Plug-in Electric and Fuel Cell Electric Vehicles Purchased in 2023 or After (fueleconomy.gov)</u>. Once at the website you will need to enter: **1)** whether the vehicle was placed in service after April 17, 2023 or before April 18, 2023; **2)** the model year; **3)** the make of the vehicle (e.g., Chevrolet, Ford, Toyota); **4)** the model (e.g., Bolt, Mustang Mach-E); and **5)** whether the vehicle is all electric or a plug-in hybrid.

- **<u>Credit For Qualified Commercial Clean Vehicles Acquired And Placed In Service After 2022 And Before 2033.</u>** The IRA provides an EV credit for depreciable commercial electric vehicles acquired and placed in service after 2022. The credit is not allowed if the taxpayer is allowed a Clean Vehicle Credit for the same vehicle. **<u>Planning Alert!</u>** A qualifying depreciable commercial EV means the vehicle is used in a trade or business or for the production of income. According to the IRS, *"business use means any use in a trade or business of the taxpayer*."

  - **<u>Credit Amount.</u>** The credit is the **lesser of: 1)** 30% of the vehicle's basis or **2)** the incremental cost of the vehicle if the vehicle is 100% electric. The 30% credit amount is reduced to 15% if the vehicle has a gasoline or diesel component (i.e., if a hybrid). The **"incremental cost"** means the excess of the purchase price of the vehicle over the price of a comparable gas- or diesel-powered vehicle. The IRS has announced that the incremental cost of vehicles with a GVWR of less than 14,000 pounds is deemed to be $7,500 except for small hybrid vehicles where the incremental cost is deemed to be $7,000. The **maximum credit allowed** is **$7,500** where the vehicle has a **GVWR of less than 14,000 pounds** and **$40,000** for a vehicle with a **GVWR of 14,000 pounds or more.**

  - **<u>Qualified Commercial Clean Vehicle.</u>** A "Qualified Commercial Clean Vehicle" is a vehicle that: **1)** is depreciable property; **2)** is acquired for use or lease by the taxpayer, and not for resale; **3)** is manufactured for use on public streets, roads, and highways, or is "mobile machinery" (including vehicles that are not designed to perform a function of transporting a load over the public highways); **4)** has a battery capacity of not less than 15 kilowatt hours (7 kilowatt hours for vehicles weighing less than 14,000 pounds) and is charged by an external electricity source; and **5)** is made by a qualified manufacturer that has a written agreement with the Treasury Department and provides reports to the Treasury Department. Qualified commercial fuel cell vehicles are also eligible for the credit. A list of qualified manufacturers can be found here – see <u>https://www.irs.gov/credits-deductions/manufacturers-for-qualified-commercial-clean-vehicle-credit</u>.

  - **<u>Other Requirements.</u>** The credit for a Qualified Commercial Clean Vehicle is not allowed if the taxpayer is allowed a Clean Vehicle Credit discussed above. As with other clean vehicle credits, a

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VIN is required on returns claiming the credit. **Planning Alert!** It seems a business that acquires a new vehicle qualifying for either the regular clean vehicle credit or this commercial clean vehicle credit may choose to take the largest of the two credits.

- **Lessors Of Commercial EVs Take The Credit If Treated As Owner Of The EV.** Recently released Q&As explain that the lessor of a qualified Commercial EV is eligible for the Clean Vehicle Credit if the lessor is treated as the owner under general tax principals. However, if the lessee is treated as the owner, the lessee is eligible for the credit.

  Q&A explains the rule as follows: *"Based on longstanding tax principles, the determination whether a transaction constitutes a sale or a lease of a vehicle for tax purposes is a question of fact. Features of a vehicle lease agreement that would make it more likely to be recharacterized as a sale of the vehicle for tax purposes include, but are not limited to:*
  - *A lease term that covers more than 80% to 90% of the economic useful life of the vehicle,*
  - *A bargain purchase option at the end of the lease term (that is, the ability to purchase the vehicle at less than its fair market value at the end of the term) or other terms/provisions in the lease that economically compel the lessee to acquire the vehicle at the end of the lease term,*
  - *Terms that result in the lessor transferring ownership risk to the lessee, for example, a terminal rental adjustment clause (TRAC) that requires the lessee to pay the difference between the actual and expected value of the vehicle at the end of the lease."*

- **Basis Of Vehicle Reduced By Credit.** The basis of the vehicle is reduced by any Commercial Clean Vehicle Credit or by any Non-Commercial Clean Vehicle Credit claimed.

- **It's Easier To Qualify For The Commercial Clean Vehicle Credit Than The Clean Vehicle Credit Discussed Previously.** The AGI limitations, the limitation on the cost of the vehicle, the requirement that final assembly of the vehicle must occur in North America, and the battery minerals and component requirements that apply to the Clean Vehicle Credit do not apply to the credit for Qualified Commercial Clean Vehicles. In addition, any unused Qualified Commercial Clean Vehicle Credit may be carried forward if the taxpayer does not have sufficient tax to use the credit. The Clean Vehicle Credit may not be carried forward. However, beginning in 2024, a taxpayer may be able to obtain benefit of the Clean Vehicle Credit, even without sufficient tax to utilize the credit, by obtaining benefit of the credit from the auto dealer.

TRADITIONAL YEAR-END TAX PLANNING TECHNIQUES

Planning With Timing Of Income And Expenses. It goes without saying that, for most business owners, the last several years have been challenging. Dealing with the pandemic, disruptions in the supply chain, and hiring and retaining good employees has caused many business owners to face issues they've never experienced. One traditional year-end tax planning strategy for business owners includes reducing current year taxable income by deferring it into later tax years and accelerating deductions into the current tax year. This strategy has been particularly beneficial where the income tax rate on the business's income in the following year is expected to be the same or lower than the current year. For businesses that have done well during the current tax year, this strategy would still generally be advisable. **Caution!** In the following discussions we include "timing" suggestions as they relate to traditional year-end tax planning strategies that would cause you to accelerate deductions into 2023, while deferring income into 2024. However, for businesses that expect their taxable income to be significantly lower in 2023 than in 2024, the opposite strategy might be more advisable. In other words, for struggling businesses, a better year-end planning strategy could include accelerating revenues into 2023 (to be taxed at lower rates), while deferring deductions to 2024 (to be taken against income that is expected to be taxed at higher rates).

Planning Alert! The 20% 199A deduction that was first available in 2018 adds another wrinkle to deciding whether to defer or accelerate revenues, and/or to defer or accelerate deductions. As discussed in more detail below, your ability to take maximum advantage of the 20% 199A deduction for 2023 and/or 2024 may, in certain situations, be enhanced significantly if you are able to keep your taxable income below

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certain thresholds. Consequently, please keep that in mind as you read through the following timing strategies for income and deductions.

First-Year 168(k) Bonus Depreciation Deduction. Traditionally, a popular way for businesses to maximize current-year deductions has been to take advantage of the **First-Year 168(k) Bonus Depreciation deduction.** Before the *"Tax Cuts and Jobs Act"* (TCJA) which was enacted in late 2017, the 168(k) Bonus Depreciation deduction was equal to 50% of the cost of qualifying **new** depreciable assets placed in service. TCJA temporarily increased the 168(k) Bonus Depreciation deduction to 100% for qualifying property acquired and placed in service **after September 27, 2017,** and **before January 1, 2023.**

Planning Alert! Beginning **with 2023,** the 100% §168(k) deduction is reduced as follows for property placed in service: **1)** During **2023 - 80%, 2)** During **2024 - 60%, 3)** During **2025 - 40%, 4)** During **2026 - 20%,** and **5) After 2026 - 0%** (with an additional year for long-production-period property and noncommercial aircraft).

The 168(k) Bonus Depreciation was enhanced by the TCJA which made the following changes:

- **"Used" Property Temporarily Qualifies For 168(k) Bonus Depreciation.** For qualifying property acquired and placed in service **after September 27, 2017, and before 2027,** the 168(k) Bonus Depreciation may be taken on **"new" or "used"** property. Therefore, property that generally qualifies for the 168(k) Bonus Depreciation includes **"new"** or **"used"** business property that has a depreciable life for tax purposes of **20 years or less** (e.g., machinery and equipment, furniture and fixtures, sidewalks, roads, landscaping, computers, computer software, farm buildings, and qualified motor fuels facilities).

  - **The 168(k) Bonus Depreciation Deduction For "Used" Property Generally Makes Cost Segregation Studies More Valuable.** Depreciable components of a building that are properly classified as depreciable personal property under a **cost segregation study** are generally depreciated over 5 to 7 years. Before TCJA, these depreciable building components for a purchaser of a "used" building generally qualified for the 179 Deduction (subject to the dollar caps) but did not qualify for a 168(k) Bonus Depreciation deduction because the 168(k)-depreciation deduction only applied to "new" property. However, the depreciable components of a building that are properly classified as "personal property" (as opposed to "real property") now qualify for the 168(k) Bonus Depreciation (whether new or used).

- **Annual Depreciation Caps For Passenger Vehicles Increased.** Vehicles used primarily in business generally qualify for the 168(k) Bonus Depreciation. However, there is a dollar cap imposed on business cars, and on trucks, vans, and SUVs that have a **loaded vehicle weight (GVWR) of 6,000 lbs. or less.** For qualifying vehicles placed in service **in 2023** and used 100% for business, the annual depreciation caps are as follows: **1st year - $12,200; 2nd year - $19,500; 3rd year - $11,700; fourth and subsequent years - $6,960.** Moreover, if the vehicle (new or used) otherwise qualifies for the 168(k) Bonus Depreciation, the first-year depreciation cap (assuming 100% business use) is **increased by $8,000 (i.e., from $12,200 to $20,200 for 2023). Planning Alert!** If a new or used truck, van, or SUV (which is used 100% for business) has a **GVWR over 6,000 lbs., 80% of its cost** (without a dollar cap) could be deducted **in 2023** as a **168(k) Bonus Depreciation deduction.**

- **168(k) Bonus Depreciation Available In Tax Year Qualifying Property "Placed In Service."** The 168(k) Bonus Depreciation deduction is taken in the tax year the qualifying property is "placed in service." Consequently, if your business anticipates acquiring qualifying 168(k) property between now and the end of the year, the 168(k) Bonus Depreciation deduction is taken in 2023 if the property is placed in service no later than December 31, 2023, if the business has a calendar tax year. Alternatively, the 168(k) Bonus Depreciation deduction can be deferred until 2024 if the qualifying property is placed in service in 2024. However, the 168(k)-depreciation deduction **is scheduled to drop to 60%** of the basis of the property if placed in service in 2024. Generally, if you are purchasing "personal property" (equipment, computer, vehicles, etc.), "placed in service" means the property is **ready and available** for use (this commonly means the date on which the property has been **set up**

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and tested). If you are dealing with building improvements (e.g., "Qualified Improvement Property"), the date on the **Certificate of Occupancy** is commonly considered the date the qualifying building improvements are placed in service. **Planning Alert!** Unlike the 179 Deduction (discussed next), the 168(k) Bonus Depreciation deduction is automatically allowed unless the business timely **elects out** of the deduction. However, the 179 deduction is not allowed unless the business makes an **affirmative election to take it.**

Section 179 Deduction. Another popular and frequently used way to accelerate deductions is by taking maximum advantage of the up-front Section 179 Deduction ("179 Deduction"). The Tax Cuts and Jobs Act (TCJA) also made several taxpayer-friendly enhancements to the 179 Deduction which include: **1)** Substantially increasing the 179 Deduction limitation (up to **$1,160,000 for 2023), 2)** Increasing the phase-out threshold for total purchases of 179 property **($2,890,000 for 2023),** and **3)** Expanding the types of business property qualifying for the 179 Deduction. **Observation!** To maximize your 179 Deductions for 2023, it is important for your business to determine which depreciable property acquired during the year qualifies as 179 Property. The following is a list of business property that qualifies for the 179 Deduction.

- **General Definition Of 179 Property.** Generally, "depreciable" property qualifies for the **179 Deduction** if: **1)** It is purchased **new or used, 2)** It is "tangible personal" property, **and 3)** It is used primarily for business purposes (e.g., machinery and equipment, furniture and fixtures, business computers, etc.). Off-the-shelf business software also qualifies. **Planning Alert!** The 179 Deduction **is now allowed** for otherwise qualifying property used in connection with lodging (e.g., the cost of furnishing a home that the owner is renting to others would now qualify).

- **Expanded Definition Of "Qualified Real Property." For property placed in service in tax years beginning after 2017, "Qualified Real Property"** (which qualifies for the 179 Deduction) means any of the following **"improvements" to an existing commercial** (i.e., nonresidential) building that are **placed in service after the commercial building was first placed in service: 1) "Qualified Improvement Property", 2) Roofs, 3) Heating, Ventilation, and Air-Conditioning Property, 4) Fire Protection and Alarm Systems, and 5) Security Systems. Tax Tip!** Determining whether a major repair to a building's roof should be capitalized or deducted immediately as a repair under capitalization regulations, is not always an easy task. Since new roofs with respect to an existing commercial building may now qualify for the 179 Deduction, in many situations, the "capitalization vs. repair" issue relating to the replacement of roofs should largely be eliminated where the 179 limitation caps for the year are not exceeded. **Planning Alert!** "Qualified Improvement Property" (QIP) also qualifies for the 80% 168(k) first-year bonus depreciation deduction as well as for the 179 Deduction, subject to the dollar limitation listed previously. "Qualified Improvement Property" generally means improvements to the interior portion of a commercial building which are placed in service after the building is placed in service and which do not expand the floor space of the building and do not involve the internal structural framework of the building.

- **Business Vehicles.** New or used business vehicles generally qualify for the 179 Deduction, provided the vehicle is **used more-than-50% in your business. Planning Alert!** As discussed previously in the 168(k) Bonus Depreciation segment, there is a dollar cap imposed on business cars and trucks that have a **vehicle weight of 6,000 lbs. or less.** If applicable, this dollar cap applies to both the 168(k) Bonus Depreciation and the 179 Deduction taken with respect to the vehicle.

  - **"Heavy Vehicles" Exempt From Dollar Caps.** Trucks, vans, and SUVs that have a loaded **weight (GVWR) of more than 6,000 lbs.** are exempt from the annual depreciation caps. In addition, these vehicles, if used more-than-50% in business, will also generally qualify for a **179 Deduction of up to $28,900** if placed in service in 2023 **($30,500** if placed in service in 2024). **Tax Tip!** Pickup trucks with loaded vehicle weights over 6,000 lbs. are exempt from the $28,900 limit to the 179 Deduction if the truck bed is at least six feet long. **Planning Alert!** The $28,900 cap applies only for purposes of the 179 Deduction. This $28,900 cap **does not apply** with respect to the 168(k) Bonus Depreciation deduction taken on vehicles weighing over 6,000 lbs.

- **Tax Tip!** Neither the **179 Deduction** nor the 168(k) Bonus Depreciation deduction requires any proration based on the length of time that an asset is in service during the tax year. Therefore, your calendar-year business would get the benefit of the **entire 179 or 168(k) Deduction** for 2023 purchases, even if the qualifying property **was placed in service as late as December 31, 2023!** However, you would claim the 168(k) and 179 deductions in 2024 if the qualifying property was placed in service on January 1, 2024, or after. Therefore, **if you want the deduction for 2023, make sure the vehicle or other qualifying property is placed in service in 2023.**

- **The 168(k) Depreciation Deduction Has Temporarily Made The Section 179 Taxable Income Limitation Less Important.** The 179 Deduction is limited to a taxpayer's "trade or business" taxable income (determined without the 179 Deduction) for the tax year. Any excess 179 Deduction over the "taxable income limitation" is carried forward to later years until the taxpayer generates enough business taxable income to fully deduct it. This generally means that this "taxable income limitation" will not limit the taxpayer's Section 179 Deduction for a specific tax year so long as the taxpayer has aggregate net income (before the section 179 Deduction) from all trades or businesses at least equal to the 179 Deduction for that tax year. For this purpose, an individual's trade or business income includes W-2 wages reported by the individual and/or the individual's spouse (if filing a joint return).

  Planning Alert! There is **no "taxable income limitation" or $28,900 cap** with respect to the 168(k) Bonus Depreciation deduction. Therefore, for example, a taxpayer could deduct **80% of the full cost** of an SUV weighing over 6,000 lbs. purchased in 2023 and used entirely for business as a **168(k) Bonus Depreciation deduction** without being limited by the $28,900 cap, and regardless of the amount of the taxpayer's taxable income.

Salaries For S Corporation Shareholder/Employees. For 2023, an employer generally must pay FICA taxes of 7.65% on an employee's wages up to $160,200 ($168,600 for 2024) and FICA taxes of 1.45% on wages in excess of $160,200 ($168,600 for 2024). In addition, an employer must withhold FICA taxes from an employee's wages of 7.65% on wages up to $160,200 ($168,600 for 2024) and 1.45% of wages in excess of $160,200 ($168,600 for 2024). Generally, the employer must also withhold an additional Medicare tax of 0.9% for wages paid to an employee in excess of $200,000. If you are a shareholder/employee of an S corporation, this FICA tax generally applies only to your W-2 income from your S corporation. Other income that passes through to you or is distributed with respect to your stock is generally not subject to FICA taxes or to self-employment taxes.

- **Compensation Must Be "Reasonable."** If the IRS determines that you have taken unreasonably "low" compensation from your S corporation, it will generally argue that other amounts you have received from your S corporation (e.g., distributions) are disguised "compensation" and should be subject to FICA taxes. Determining "reasonable compensation" for S corporation shareholder/employees continues to be a hot audit issue, and the IRS has a winning record in the Courts. Over the years, the IRS has been particularly successful in reclassifying distributions as wages where S corporation owners pay themselves **no wages** even though they provided significant services to the corporation. However, more recently, there have been several cases where the S corporation owners paid themselves **more than de minimis wages,** but the Court still held that an additional portion of their cash "distributions" should be reclassified as "wages" (subject to payroll taxes). **Caution!** Determining "reasonable" compensation for an S corporation shareholder is a case-by-case determination, and there are no rules of thumb for determining whether the compensation is "reasonable." However, Court decisions make it clear that the compensation of S corporation shareholders should be supported by independent data (e.g., comparable industry compensation studies), and should be properly documented and approved by the corporation. **Planning Alert!** Keeping wages low and minimizing your FICA tax could also reduce your Social Security benefits when you retire. Furthermore, if your S corporation has a qualified retirement plan, reducing your wages may reduce contributions that can be made to the plan on your behalf since contributions to the plan are based on your "wages."

S Corporation Shareholders Should Check Stock And Debt Basis Before Year-End. If you own S corporation stock and you think your S corporation will have a tax loss this year, you should **contact us as soon as possible.** These losses will not be deductible on your personal return unless and until you have

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adequate "basis" in your S corporation. Any pass-through loss that exceeds your "basis" in the S corporation will carry over to succeeding years. You have basis to the extent of the amounts paid for your stock (adjusted for net pass-through income, losses, and distributions); **plus,** any amounts you have personally loaned to your S corporation. **Planning Alert!** If an S corporation anticipates financing losses through borrowing from an outside lender, the best way to ensure the shareholder gets **debt basis** is to: **1)** Have the shareholder personally borrow the funds from the outside lender, and **2)** Then have the shareholder formally (with proper and timely documentation) loan the borrowed funds to the S corporation. It may also be possible to restructure (with timely and proper documentation) an existing outside loan directly to an S corporation in a way that will give the shareholder debt basis. However, the loan must be restructured before the S corporation's year ends. **Caution!** A shareholder cannot get debt basis by merely guaranteeing a third-party loan to the S corporation. **Please do not attempt to restructure your loans without contacting us first.**

MAXIMIZE YOUR 20% 199A DEDUCTION FOR QUALIFIED BUSINESS INCOME (QBI)

First effective in 2018, the 20% 199A Deduction has had a major impact on businesses. This provision allows qualified taxpayers to take a 20% Deduction with respect to **"Qualified Business Income," "Qualified REIT Dividends,"** and **"Publicly Traded Partnership Income."** Of these three types of qualifying income, **"Qualified Business Income" (QBI)** has had the biggest impact by far on the greatest number of taxpayers. Consequently, this discussion of the 20% 199A Deduction focuses **primarily on "Qualified Business Income" (QBI). Planning Alert!** The rules for determining the 20% 199A Deduction for Qualified REIT Dividends and Publicly Traded Partnership Income are relatively straight forward.

Highlights Of The 20% 199A Deduction For "Qualified Business Income" (QBI). In certain situations, the rules for determining whether a taxpayer qualifies for the 20% 199A Deduction with respect to **Qualified Business Income (QBI)** can be quite complicated. Consequently, the discussion below provides only an "overview" of the primary requirements for a taxpayer to be eligible for the 20% 199A Deduction as it applies to QBI.

- **Who Qualifies For The 20% 199A Deduction With Respect To "Qualified Business Income" (QBI)?** Taxpayers who may qualify for the 20% 199A Deduction are generally taxpayers that report **"Qualified Business Income" (QBI)** as: Individual owners of S corporations or partnerships; Sole Proprietors; Trusts and Estates; and Certain beneficiaries of trusts and estates. **Planning Alert!** The 20% 199A Deduction is available **for tax years beginning after 2017 through 2025 and** is generally taken on the owner's individual income tax return. The 20% 199A Deduction does not reduce the individual owner's "Adjusted Gross Income" (AGI) or impact the calculation of the owner's Self-Employment Tax. Instead, the deduction simply reduces the owner's Taxable Income (regardless of whether the owner itemizes deductions or claims the standard deduction). In other words, the 20%199A Deduction is allowed **in addition to** an individual's itemized deductions or standard deduction.

- **Rules For 20% 199A Deduction For QBI Are Much Simpler For Taxpayers With 2023 "Taxable Income" Of $182,100 Or Below ($364,200 Or Below If Filing Joint Return).** Computing the 20% 199A Deduction for QBI for some taxpayers can be extremely tricky. However, as you read the following discussion, you will discover that certain rules that could otherwise limit the amount of the 20% 199A Deduction do not apply to taxpayers with Taxable Income below certain levels. Consequently, the technical rules for determining (and qualifying for) the 20% 199A Deduction for QBI are far simpler and easier for individuals with 2023 "Taxable Income" (excluding the 20% 199A Deduction) of **$182,100 or below ($364,200** or below if married filing jointly).

- **"Qualified Business Income." "Qualified Business Income" (QBI)** generally eligible for the 20% 199A Deduction, is defined as the net amount of qualified items of income, gain, deduction, and loss with respect to **"any"** trade or business **other than: 1)** Certain **personal service** businesses known as **"Specified Service Trades Or Businesses"** (described in more detail below), and **2)** The **Trade or Business** of performing services **"as an employee"** (e.g. W-2 wages). **Caution!** QBI also generally **does not include** certain items of income, such as: **1)** Dividends, investment interest income,

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short-term capital gains, long-term capital gains, income from annuities, commodities gains, foreign currency gains, etc.; **2)** Any **"guaranteed payment"** paid to a partner by the partnership; **3)** Reasonable compensation paid by an S corporation to a shareholder; or **4)** Income you report as an independent contractor (e.g., sole proprietor) where it is ultimately determined that you should have been classified as a "common law" employee.

- **"Depreciation Recapture Income" May Be Treated As QBI.** As mentioned previously, a capital gain or loss (long-term or short-term) is excluded from the determination of QBI. However, on the sale of depreciable "personal" business property, the gain is generally treated as "ordinary" gain (not "capital" gain) to the extent the seller previously took either depreciation or the 179 Deduction with respect to that property. This is commonly referred to as "Depreciation Recapture Gain." Depreciation Recapture Gain (i.e., treated as "ordinary" gain) with respect to a qualifying business is included in the calculation of QBI. **Planning Alert!** Depreciation Recapture Gain most commonly occurs when a taxpayer sells depreciable **"personal"** property (e.g., business equipment, furniture and fixtures, certain business vehicles, etc.). However, the sale of depreciable **"real"** property (e.g., depreciable buildings used in a commercial business) in certain situations can also generate Depreciation Recapture Gain. For example, if a taxpayer takes the 179 Deduction with respect to qualifying improvements (e.g., new roof, Qualified Improvement Property) to a commercial building and later sells the building, the sale can trigger Depreciation Recapture Gain to the extent of the previous 179 Deduction. If, at the time of the sale, the building had been used in a business that was otherwise generating QBI, the Depreciation Recapture Gain on the sale of the building resulting from the 179 Deduction would likewise be included in QBI.

- **"Ordinary Gain" On The Sale Of A Partnership Interest Could Generate QBI.** Generally, the gain on the sale of a partnership interest is classified as a "capital" gain which is excluded from the computation of QBI. However, code section 751 of the internal revenue code requires a partner to treat income from the sale of the partner's partnership interest as "ordinary" gain (not "capital" gain) to the extent of the partner's share of the partnership's "Unrealized Receivables" (e.g., zero-basis receivables held by a cash-basis partnership; Depreciation Recapture Gain reflected in the partnership's depreciable property) and "Substantially Appreciated Inventory." Gain on the sale of a partnership interest to the extent it is treated as "ordinary" gain under code section 751(a) is considered attributable to the trades or businesses conducted by the partnership. Therefore, if the partnership is generating QBI at the date of the sale of the partnership interest, the "ordinary" gain triggered to the selling partner under code section 751 should also be included in the partner's QBI. **Note!** Unlike partnerships, no portion of the gain or loss on the sale of S corporation stock will be included in the determination of QBI.

- **W-2 Wage And Capital Limitation On The 20% QBI Deduction.** Generally, your 20% QBI Deduction with respect to each Qualified Trade or Business may not exceed **the greater of: 1)** 50% of the allocable share of the business's W-2 wages allocated to the QBI of each "Qualified Trade or Business," or **2)** The sum of 25% of the business's allocable share of W-2 wages with respect to each "Qualified Trade or Business," plus 2.5% of the business's allocable share of unadjusted basis of tangible depreciable property held by the business at the close of the taxable year. **Note!** This limitation, to the extent it applies, is generally designed to ensure that the full 20% of QBI Deduction is available only to qualified businesses that have sufficient W-2 wages, sufficient tangible depreciable business property, or both.

- **Owners With Taxable Income Below Certain Thresholds Are Exempt From The W-2 Wage And Capital Limitation!** For 2023, an otherwise qualifying taxpayer is **entirely exempt** from the **W-2 Wage and Capital Limitation** if the Taxpayer's **"Taxable Income"** (computed without regard to the 20% 199A Deduction) is **$182,100 or below ($364,200** or below if married filing jointly). **Caution!** For 2023, the Wage and Capital Limitation phases in ratably as a taxpayer's Taxable Income **goes from more than $182,100 to $232,100, or from more than $364,200 to $464,200** (if filing jointly).

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- **<u>"Specified Service Trade Or Businesses" (SSTBs) Income Does Not Qualify For The 20% 199A Deduction For Owners Who Have "Taxable Income" Above Certain Thresholds.</u>** Based on "Taxable Income" (before the 20% 199A Deduction), all or a portion of qualified business income from a so-called "Specified Service Trade or Business" (i.e., certain service-type operations discussed in more detail below) **may not qualify** for the 20% 199A Deduction. More specifically, if **"Taxable Income"** for 2023 (before the 20% 199A Deduction) is **$182,100 or below ($364,200 or below** if married **filing jointly), all** the qualified business income from a "Specified Service Trade or Business" **(SSTB)** is eligible for the 20% 199A deduction. However, if for 2023 **"Taxable Income"** is **$232,100 or more ($464,200 or more** if married **filing jointly), none** of your SSTB income qualifies for the 20% 199A Deduction. **<u>Caution!</u>** If for 2023, your **"Taxable Income"** is **between $182,100 and $232,100** (between **$364,200 and $464,200** if married **filing jointly),** only **a portion** of your SSTB income will be eligible for the 20% 199A Deduction.

  <u>Planning Alert!</u> A taxpayer with Taxable Income for 2023 of **$182,100 or less ($364,200** or less if married filing jointly) qualifies for two major benefits: **1)** The taxpayer's SSTB income (if any) is fully eligible for the 20% 199A deduction, ***and*** **2)** The taxpayer is completely exempt from the W-2 Wage and Capital Limitation. Consequently, if you are in a situation where your 20% 199A Deduction would otherwise be significantly reduced (or even eliminated altogether) due to either or both limitations, it is even more important that you review year-end strategies that could help you reduce your 2023 taxable income (before the 20% 199A Deduction) to or below the $182,100/$364,200 thresholds.

- **<u>What Is A "Specified Service Trade Or Business" (SSTB)?</u>** A ***Specified Service Trade or Business*** **("SSTB")** is generally defined as: **1)** a trade or business activity involved in the performance of services in the field of: health; law; accounting; actuarial science; performing arts; consulting; athletics; financial services; or brokerage services; **2)** a trade or business involving the receipt of fees for celebrity-type endorsements, appearance fees, and fees for using a person's image, likeness, name, etc.; and **3)** any trade or business involving the services of investing and investment management, trading, or dealing in securities, partnership interests, or commodities. An "SSTB" **does not include** the performance of **architectural** or **engineering** services.

  <u>Planning Alert!</u> One of the listed activities that constitutes an SSTB is *"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."* The IRS says this type of SSTB is not nearly as broad as it sounds. More specifically, regulations under section 199A clarify that this classification **only includes** the following types of business income: Fees for celebrity-type endorsements, appearance fees, and fees for using a person's image, likeness, name, etc. The regulations also clarify this type of activity **<u>does not include</u>** the income of a business, other than the three types of income listed above, even if the income is generated, to a large degree, by the good business reputation of the owners and/or employees.

- **<u>Evaluating Reasonable W-2 Compensation Paid To S Corp Owner/Employees Is Even More Important Now.</u>** S corporation shareholder/employees have had an incentive to pay themselves W-2 wages as low as possible because only the shareholder's W-2 income from the S corporation is subject to FICA taxes. Other income of the shareholder from the S corporation is generally not subject to FICA or Self-Employment (S/E) taxes. Traditionally, where the IRS has determined that an S corporation shareholder/employee has taken unreasonably **"low"** compensation from the S corporation, the IRS has argued that other amounts the shareholder has received from the S corporation (e.g., distributions) are disguised **"compensation"** and should be subject to FICA taxes. In light of the 20% 199A Deduction, reviewing the amount of W-2 wages for Shareholder/Employees of S Corporations becomes even more important as we illustrate below:

  - **For example,** for S Corporation shareholder/employees who expect 2023 Taxable Income (before the 20% 199A Deduction) of **$182,100 or less ($364,200 or less** if married filing jointly), **there is a tax incentive** to keep the shareholders' **W-2 wages as "low" as possible,** because: **1)** The W-2 Wages paid to shareholders **do not qualify** for the 20% 199A Deduction, but the W-2 Wages **do reduce** a shareholder's pass-through Qualified Business Income, **2)** The shareholder will be exempt from the W-2 Wage and Capital Limitation (so lower W-2 wages will

not limit the shareholder's potential 20% 199A Deduction amount), and **3)** The shareholder's pass-through SSTB income (if any) will be eligible for the 20% 199A Deduction, while W-2 wages paid to the shareholder/employee will not qualify. **Caution!** As mentioned previously, the IRS has a long history of attacking S Corporations it believes are paying shareholder/employees unreasonably low W-2 wages.

By contrast, for S Corporation shareholder/employees who expect to have Taxable Income (before the 20% 199A Deduction) of **$232,100 or more ($464,200 or more** if married filing jointly), there **may be a tax incentive to "increase"** the shareholder's W-2 wages if: **1)** The S corporation is generating pass-through Qualified Business Income (QBI), and **2)** The W-2 Wage and Capital Limitation will significantly limit the amount of the Shareholder/employee's 20% 199A Deduction unless the S corporation increases the W-2 wages paid to the shareholder/employee. However, increasing the shareholder/employee's W-2 wages will increase the payroll tax liability of the S corporation and the shareholder. Therefore, careful calculations should be made before adopting this strategy.

Planning Alert! If you want our firm to review the W-2 wages your S corporation is currently paying to its shareholders due to the 20% 199A Deduction, please **contact us as soon as possible.** We will evaluate your specific situation and make recommendations. **Caution!** The quicker you contact us on this issue, the better chance you have to take action before the end of 2023 to increase your 20% deduction.

- **Payments By A Partnership To A Partner For Services.** A partner's pass-through share of **QBI** generally **"is eligible"** for the 20% 199A Deduction. Moreover, payments by the partnership to the partner that are properly classified as **"distributions"** neither reduce nor increase the partnership's QBI that passes through to its partners. However, the following types of payments to a partner by a partnership **do reduce** the **amount of QBI** otherwise generated by a partnership, and are also **"not eligible"** for the 20% 199A Deduction: **1)** Any amount that is a **"guaranteed payment"** paid by the partnership to the partner, or **2)** Any amount allocated or distributed by a partnership **to a partner** for services provided to the partnership where it is ultimately determined that the partner was **acting other than in** his or her capacity as a partner. **Caution!** It is not always clear whether specific payments to a partner will be classified as "distributions" (that generally do not reduce the 20% 199A Deduction), or alternatively fall into one of the two above-listed categories that are not eligible for the 20% 199A Deduction. Often partnerships call distributions to partners "guaranteed payments" when they are not technically guaranteed payments. Generally, guaranteed payments are payments made to partners without regard to the partnership's income. If payments to partners are merely distributions of profits or advance distributions of profits, they are probably not guaranteed payments and should not be classified as such and should not reduce the QBI of the partnership.

- **250-Hour Safe Harbor For Rental Real Estate.** For any business activity to generate **"Qualified Business Income" (QBI),** the activity must constitute a **"trade or business".** For Federal income tax purposes, there has always been uncertainty whether and when a "real estate rental" activity is considered a "trade or business". In response to that uncertainty, the IRS has released guidance that presumes a rental real estate activity is a "trade or business" **for purposes of the 20% 199A Deduction.** This presumption generally applies if the owner, employees, and independent contractors, in the aggregate, provide 250 or more hours of qualifying services with respect to the rental property during the tax year.

  Planning Alert! Failing to satisfy this 250-hour safe harbor only means the rental real estate activity will not be "presumed" to be a "trade or business" for purposes of the 20% 199A Deduction. For those who fail to satisfy this safe harbor, depending on the facts, it may still be possible for the owner to successfully argue that the rental real estate activity constitutes a "trade or business" under general common law principles or when the property is rented to a business controlled by the owner and in which the owner materially participates. **Note!** This 250-hour safe harbor contains several rules and requirements that are too lengthy to address in this letter. If you own rental real estate that is generating net rental income, feel free to **call our firm** and we will gladly review your specific situation and

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determine if your rental real estate activity is a trade or business qualifying for the 20% 199A Deduction using the 250-hour safe harbor or one of the other trade or business tests.

BE CAREFUL WITH EMPLOYEE BUSINESS EXPENSES

Un-Reimbursed Employee Business Expenses Are Not Deductible. For 2018 through 2025, "un-reimbursed" employee business expenses are not deductible at all by an employee. For example, an employee **may not deduct** on the employee's income tax return any of the following business expenses **incurred as an "employee", even if the expenses are necessary for the employee's work - Automobile expenses** (including auto mileage, vehicle depreciation); **Costs of travel, transportation, lodging and meals; Union dues** and expenses; **Work clothes and uniforms;** Otherwise qualifying **home office expenses; Dues** to a chamber of commerce; **Professional dues; Work-Related education expenses; Job search expenses; Licenses and regulatory fees; Malpractice insurance premiums; Subscriptions** to professional journals and trade magazines; and **Tools and supplies** used in your work.

An Employer's Qualified Reimbursement Of An Employee's Business Expenses Are Deductible By The Employer And Tax-Free To The Employee. Generally, employee business expenses reimbursed under an employer's qualified **"Accountable Reimbursement Arrangement" are deductible by the employer** (subject to the 50% limit on business meals), and the reimbursements are **not taxable to the employee.** However, reimbursements under an arrangement that is not a qualified "Accountable Reimbursement Arrangement" generally must be treated as compensation and included in the employee's W-2, and the employee would get no offsetting deduction for the business expense. **Planning Alert!** Generally, for a reimbursement arrangement to qualify as an **"Accountable Reimbursement Arrangement": 1)** The employer must maintain a reimbursement arrangement that requires the employee to substantiate covered expenses; **2)** The reimbursement arrangement must require the return of amounts paid to the employee that are in excess of the amounts substantiated; and **3)** There must be a business connection between the reimbursement (or advance) and the business expenses.

Deductions For Business Meals. Generally, only 50% of the cost of business meals (i.e., food and beverages) is deductible. In addition, a business may deduct 50% of the cost of food and beverages provided during a nondeductible entertainment activity with a business associate provided the food and beverages are purchased separately from the entertainment, or the cost of the food and beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts. **Caution!** If an employer reimburses an employee's deductible business food and beverage expense under an Accountable Reimbursement Arrangement, the employer could deduct 50% of the reimbursement. However, as discussed previously, an employee who is not reimbursed by the employer for the business meal would get no deduction because un-reimbursed employee business expenses are not deductible by employees (from 2018 through 2025).

OTHER SELECTED YEAR-END PLANNING CONSIDERATIONS FOR BUSINESSES

IRS Increases Standard Mileage Rates Effective January 1, 2023. The standard mileage deduction rate for deductible **business miles** was increased from 62.5 cents per mile to **65.5 cents per mile** effective January 1, 2023. The **charitable mileage rate is still 14.0 cents per mile** and the rate for **medical and moving mileage remained at 22.0** cents per mile for 2023. **Planning Alert!** Be sure to keep proper records for business, medical/moving, and charitable mileage for use as a possible deduction for 2023. **Note!** Moving expenses are not deductible for 2018 through 2025 except for certain military personnel.

Consider Simplified Accounting Methods For Certain Small Businesses. The Tax Cuts And Jobs Act (enacted in late 2017) provides the following accounting method relief provisions for businesses with **Average Gross Receipts (AGRs)** for the **Preceding Three Tax Years** of **$29 Million or Less (for 2023): 1)** Generally allows businesses to use the cash method of accounting even if the business has inventories, **2)** Allows simplified methods for accounting for inventories, **3)** Exempts businesses from applying UNICAP, and **4)** Liberalizes the availability of the completed-contract method. **Planning Alert!** The IRS has released

detailed regulations and procedures to follow for taxpayers who qualify and wish to change their accounting methods in light of these relief provisions. **Please call our firm** if you want us to help determine whether any of these simplified accounting methods might be available to your business.

No Deduction For Expenses Of A "Hobby". Previously, otherwise deductible trade or business expenses attributable to an activity that was *"not engaged in for profit"* (i.e., a hobby loss activity) were deductible: **1)** only as *miscellaneous itemized deductions,* and **2)** only to the extent of the activity's gross income. Since these hobby loss expenses are classified as miscellaneous itemized deductions, no deduction is allowed for these expenses ***from 2018 through 2025.*** **Planning Alert!** This makes it even more important for owners engaged in activities commonly subject to IRS scrutiny, to take steps to demonstrate the business is operated with the intent to make a profit.

- **Three Out Of Five Year Rule Or Two Out Of Seven Year Rule.** To reduce the potential controversy over the question of profit motive, Congress provided that if an activity generates gross income more than expenses in three years out of five (two years out of seven in the case of raising, showing, or racing horses) the activity is presumed to be engaged in for profit. **Planning Alert!** If the IRS challenges your business losses for the first few years of activity, let us know. We may be able to make an election to extend the statute and prevent a "hobby loss" disallowance until the business has been operating for five years (seven years for a horse activity).

- **Protecting Against Hobby Classification.** To avoid a loss of all deductions related to a business activity that is not profitable, you should: **1)** investigate the potential profitability of a new business activity and document the investigation before entering into the business; **2)** prepare a business plan before entering into a new business activity; **3)** maintain a separate business bank account and good books and records; and **4)** document any changes made and persons consulted to help produce a profit. **Please call us if you need help with this process.**

Lower Form 1099-K Threshold For 2023 Transactions. For each calendar year between 2010 and 2022, Payment Settlement Entities have been required to file Form 1099-K annually with the IRS with respect to payees and furnish information to the payees, reporting the gross amount of reportable payment transactions. **However, prior to 2023,** third-party settlement organizations were not required to file Form 1099-K where: **1)** the payee had **200 or fewer otherwise reportable transactions** during the calendar year and **2)** the **gross amount of such transactions during the calendar year was $20,000 or less.**

"Payment Settlement Entities" generally include banks or other organizations that process credit card transactions on behalf of a merchant and make an interbank transfer of funds to the merchant from a customer. However, reporting is also required for payments through a third-party network, a third-party settlement organization — generally, a bank or other organization with a contractual obligation to make a payment in settlement of a payment card transaction. These include payment services such as PayPal, Venmo, and CashApp. They also include online auction payment facilitators and marketplaces connecting independent sellers with customers, such as eBay and Etsy. Some gig-work platforms, including Uber, Lyft, and TaskRabbit, are either third-party settlement organizations or use them to pay gig workers.

- **American Rescue Plan Act Changed The 1099-K Reporting Threshold To $600.** The American Rescue Plan Act lowered the exception from filing Form 1099-K by Payment Settlement Entities to gross payments of **$600 or less, with no minimum number of transactions.** The new $600 reporting threshold applies beginning with 2023 transactions.

- **Caution!** The American Rescue Plan Act provided that only payments for goods and services are reportable third-party network transactions. Payment services such as PayPal and Venmo generally allow users to designate a payment as personal. The Taxpayer Advocate Service advises taxpayers to *"Be sure to ask those friends or family members to correctly designate the payment as a non–business-related transaction and then make a note yourself of what the payment was for and from whom it was received."*

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Timing Of Year-End Bonuses Can Reduce Taxes. Employers may benefit from timing the payment of year-end bonuses. Employers using the cash method of accounting for income tax purposes can deduct bonuses when paid. This allows the employer to take the deduction in the year it produces the most tax benefit by paying the bonus in the current year or delaying payment until next year. Employers using the accrual method of accounting for income tax purposes may deduct bonuses in the year accrued assuming the bonuses can be determined by the end of the tax year and are paid within 2½ months after the end of the tax year. Accrual method employers can also push the deduction for bonuses into the following tax year by not paying the bonuses within the 2½ month time frame or by changing the bonus calculation so that the bonuses are unable to be determined by year-end.

Don't Forget To Properly Document And Provide Details For Charitable Contributions. It is important to provide the IRS with all the necessary documentation for any charitable contributions made during 2023 in order to deduct them against taxable income. The IRS recently denied Hobby Lobby's charitable contributions in the amount of $84.6 million because the fair market value and basis of each item contributed were not properly reported on Form 8283. **Please call our firm** for help if you are concerned about what documentation you need to deduct a contribution.

FINAL COMMENTS

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our Firm closely monitors these changes. In addition, **please call us before implementing any planning idea discussed in this letter, or if you need additional information concerning any item mentioned in this letter.** We will gladly assist you. **Note!** The information contained in this material should not be relied upon without an independent, professional analysis of how any of the items discussed may apply to a specific situation.

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