Thoughts on Planning As 2020 Nears Its End

by Tom Zoebelein & Clara Benitez

They say hindsight is "20/20." Frankly, we are looking forward to 2020 being hindsight. The 2020 tax season is waning – with only the September, October, and November 15th extension deadlines remaining to close the most challenging tax season of our careers. Despite the overwhelming nature of the past few months – and the three deadlines still ahead of us – we find our minds already turning towards next year. Before we can put 2020 in the books and take a moment to relax, we have several tax planning items to consider for 2021.

Net Investment Income Tax and Additional Medicare Taxes Protective Claims

The US Supreme Court has granted certiorari to hear the case Texas v. United States, 945 F. 3d 355 (5th Cir. 2019) to determine the constitutionality of the Affordable Care Act. This case challenges the Net Investment Income Tax (IRC §1411) and the Additional Medicare Tax (IRC §3101(b)(2)). The case will be heard sometime in 2021. As of July 15, 2020, our firm filed a number of protective claims for refunds for clients who paid these taxes on their 2016 Forms 1040, and who originally filed by July 15, 2017. The deadline to file a protective claim is three years from the later of the return's original filing date or due date, so some clients who extended their 2016 tax returns still have time. The protective claim only activates if the Supreme Court rules in favor of the plaintiff and does not keep the statute open for any other tax issues. Remember to discuss whether to file protective claims for 2017 (due April 15, 2021) in your year-end planning sessions with your effected clients.

PPP Loan Forgiveness

The jury is still out on loan forgiveness even though the SBA designated August 10, 2020, as the date for lenders to start receiving forgiveness applications. Lenders are still waiting for guidance. The best advice we can give is to wait a little longer before jumping into the PPP forgiveness process. Borrowers have ten months after the completion of the covered period to file for forgiveness. There are currently too many unanswered questions. For example, there has been a recent legislative push for automatic forgiveness of loans of $150,000 or less.

We do know that the changes enacted June 5, 2020, expanded the covered period from eight to 24 weeks for all borrowers. Those who received loans before that date, however, can elect the eight-week covered period. Borrowers receiving PPP loans on or after June 5, 2020, will keep the same one percent interest rate and five-year term. Be sure that employee compensation remains at least 75% of 2019 levels and at least 60% of the PPP loan is used for payroll. Additionally, it is vital that employment levels be maintained for the covered period to avoid a forgiveness reduction. This may make electing eight weeks preferable if employment levels diminished after PPP funds were expended. There are exceptions for employee refusals to return and industries directly impacted by COVID-19 restrictions. There are other exceptions, like the restoration of the workforce by December 31, 2020, but those rules need further guidance.

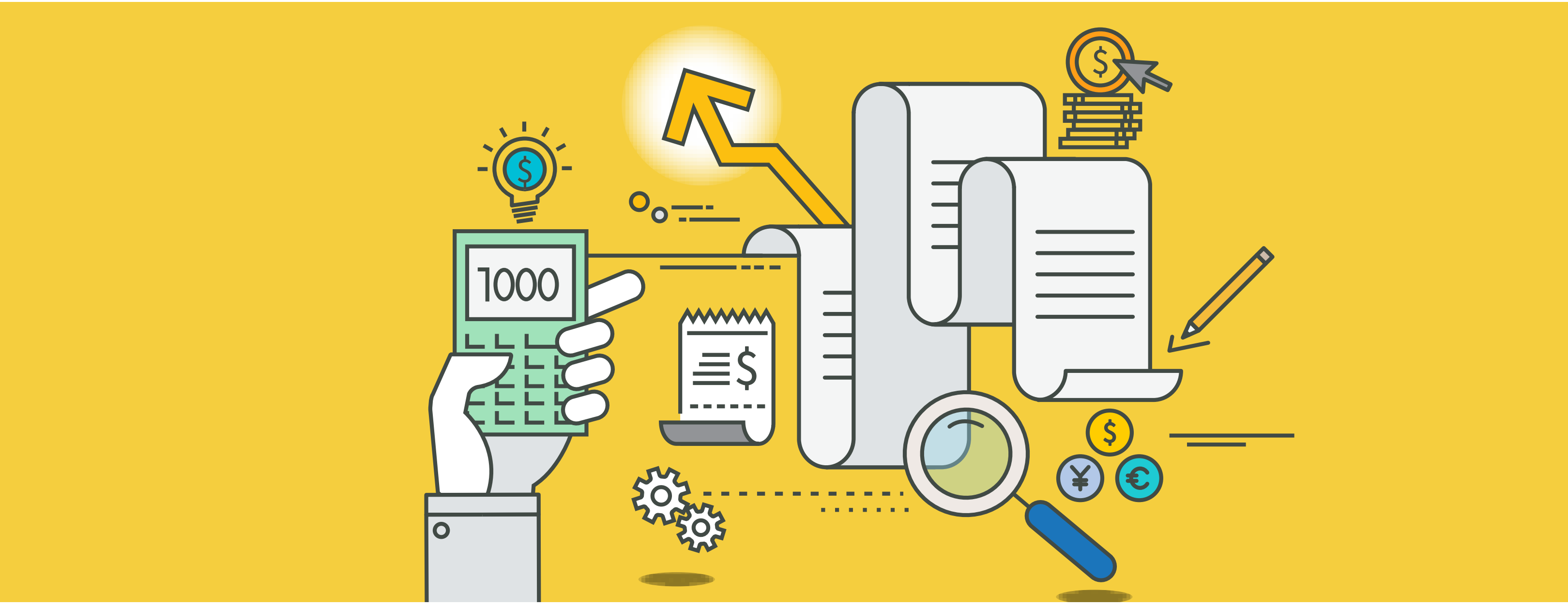
The expansion increased the compensation ceiling from $15,384 for the eight-week period to $46,154 for the 24-week period. Owners' covered cash compensation is limited $20,833, regardless of entity type. This is a single cap that includes all entities they own. C-corporation and S-corporation owner-employees may include employer retirement contributions to their employee retirement plans, capped at 2.5/12 of their 2019 amount. Two percent or greater S-corporation owner-employees cannot include health insurance payments in payroll costs, but C-corporation owner-employees may. The self-employed, including partners, cannot include payments for retirement or health insurance. A rule of thumb for pass-through owners is if it is included in either guaranteed payments or W-2 income it is limited to the $20,833 cap. LLC owner-employees must follow the rules which apply to how their business was organized for tax filing purposes for 2019.

One more fact to ponder is that both the LLC member and the S-corporation shareholder will include in income their individual PPP payments from the entities they own, but self-employed Schedule C filers should not. After all, that would make Schedule C filers' PPP loan taxable.

The PPP forgiveness applications are filed on SBA Forms 3508 and 3508EZ. As the name implies the 3508EZ is easier, if your client can use it.

NOL Treatment

The CARES Act changed the NOL carryback for tax years 2018 - 2020. Forms 1139 (corporate) and 1045 (individuals) for 2018 had to be filed by June 30, 2020. The carryback is still available but must be filed via an amended return. For clients who decided not to make the carryback, I believe it necessary to amend 2018 to elect the loss carryforward (same for



2019, if not elected). Remember, the 2019 NOL carryback on Forms 1139 and 1045 must be filed by December 31, 2020, giving the IRS only 90 days to act on the refund claim. Also, the TCJA $500,000 and 80% of taxable income loss caps are removed for tax years 2018 - 2020 under the CARES Act.

For clients facing a 2020 NOL, consider ways to increase the loss to take advantage of the five-year carryback in your 2020 planning.

Business Interest Limitation §163(j)

Section 163(j) limited business interest to 30% of "adjusted taxable income," with excess interest expense carried forward. The CARES Act increased that limit to 50% for 2019 and 2020 for corporations. This is now extended to partnerships for 2020 as well. Both corporations and partnerships can elect to use their 2019 income to compute the 2020 limitation. This is an election, so also consider the implications in other areas, like the §199A deduction for non-corporate clients, as the disallowed interest is carried over. Realty companies (now including nursing homes) and farmers can elect out of this limitation and use the ADS depreciation.

Qualified Improvement Property Fifteen-Year Property

The TCJA attempted to move all improvements to the interior of buildings into one fifteen-year category called "qualified improvement property," but instead inadvertently made it all 39-year property. This included leasehold improvements, restaurant property, retail property, and property that failed the fifteen-year category because the building was not three years old or it was owner-occupied. The CARES Act retroactively (to 2018) made it all fifteen-year property and subject to bonus. We want to emphasize the importance of it including owner-occupied improvements. This is a huge change as it eliminates the related party rule that also prevented the use of the fifteen-year property under pre-TCJA interior improvements. Consider amending 2018 and 2019 to take advantage of this change. You will need to file a Form 3115 using DCN 244 for the change to fifteen-year property and DCN 245 if you want to elect out of bonus or elect ADS. Like the NOL treatment, tax returns already filed may need to be amended to take or elect out of bonus for this property for 2018 and or 2019. Remember it is allowed or allowable.

Amending 2018 and 2019 Tax Returns

There is a natural tendency not to amend tax returns, the thought being "why give the IRS a second look at our clients' returns?" In the case of the major retroactive changes originated by the CARES Act, that adage loses some of its wisdom. Your client's return, after all, will be one in a sea of expected amended returns. Do not give it a second thought and do not lose sight of the elections that the retroactive changes require to even stay in the same tax position as pre-CARES Act.

Final Thoughts to Remember

- The CARES Act increased the income limits for charitable contributions made in 2020 for both individuals and corporations and added an "above-the-line" charitable deduction for individuals who do not itemize.
- The CARES Act allows employers to defer paying the employer portion of Social Security tax that is due from March – December 2020, until 2021 and 2022. Self-employed taxpayers may similarly delay paying their self-employment tax in. These are unavailable if the taxpayer had a PPP loan.
- Unemployment payments are taxable.
- Student loan forbearance will result in an approximately 50% reduction in individual taxpayers' student loan interest deductions for 2020.
- Unless the Alabama Legislature acts to make them nontaxable, the economic stimulus payments are taxable to Alabama.
- Congress' next round of COVID-19 relief might include a new round of PPP loans for those suffering a 50% loss of business.
- If there is a change in administration after the November election, consider possible tax rate increases, such that maximizing 2020 taxable income may be a wise move.
- Will the expenses paid with PPP money be deductible? The IRS has already said no, but Congress may say yes.
- Revisit whether your clients now qualify as small businesses (allowing them to use the cash method of accounting, the completed contract method, etc.). For 2020, the test is $26 million average revenue.

Here's hoping for a better 2021.