Key Tax Provisions and 2021 Year-End Planning for Your Business

With year-end approaching, it is time to start thinking about moves that may help lower your business taxes for this year and next. This year's planning is more challenging than usual due to the uncertainty surrounding pending legislation that could increase corporate tax rates and the top rates on both business owners' ordinary income and capital gain starting next year.

Whether or not tax increases become effective next year, the standard year-end approach of deferring income and accelerating deductions to minimize taxes will continue to produce the best results for most small businesses, as will the bunching of deductible expenses into this year or next to maximize their tax value.

If proposed tax increases do pass, however, businesses and owners in the highest income brackets may find that the opposite strategies produce better results: Pulling income into 2021 to be taxed at currently lower rates, and deferring deductible expenses until 2022, when they can be taken to offset what would be higher-taxed income. This will require careful evaluation of all relevant factors.

We have compiled a list of actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all of them will apply to you or your business, but you may benefit from many of them. Please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves might be beneficial:

- Taxpayers other than corporations may be entitled to a deduction of up to 20% of their qualified business income. For 2021, if taxable income exceeds $329,800 for a married couple filing jointly, (about half that for others), the deduction may be limited based on whether the taxpayer is engaged in a service-type trade or business (such as law, accounting, health or consulting), the amount of W-2 wages paid by the business, and/or the unadjusted basis of qualified property (such as machinery and equipment) held by the business. The limitations are phased in. For example, the phase-in applies to joint filers with taxable income up to $100,000 above the threshold, and to other filers with taxable income up to $50,000 above their threshold.

- Taxpayers may be able to salvage some or all of this deduction, by deferring income or accelerating deductions to keep income under the dollar thresholds (or be subject to a smaller deduction phaseout) for 2021. Depending on their business model, taxpayers also may be able increase the deduction by increasing W-2 wages before year-end. The rules are quite complex, so don't make a move in this area without consulting us.

- More small businesses are able to use the cash (as opposed to accrual) method of accounting than were permitted to do so in earlier years. To qualify as a small business a taxpayer must, among other things, satisfy a gross receipts test, which is satisfied for 2021 if, during a three-year testing period, average annual gross receipts don't exceed $26 million (next year this dollar amount is estimated to increase to $27 million). Not that many years ago it was only $1 million. Cash method taxpayers may find it a lot easier to shift income, for example by holding off billings until next year or by accelerating expenses, for example, paying bills early or by making certain prepayments.

- Businesses should consider making expenditures that qualify for the liberalized business property expensing option. For tax years beginning in 2021, the expensing limit is $1,050,000, and the investment ceiling limit is $2,620,000. Expensing is generally available for most depreciable property (other than buildings) and off-the-shelf computer software. It is also available for interior improvements to a building (but not for its enlargement), elevators or escalators, or the internal structural framework), for roofs, and for HVAC, fire protection, alarm, and security systems. The generous dollar ceilings mean that many businesses that make timely purchases will be able to currently deduct most if not all their outlays for machinery and equipment. What's more, the expensing deduction is not prorated for the time that the asset is in service during the year. So expensing eligible items acquired and placed in service in the last days of 2021, rather than at thebeginning of 2022, can result in a full expensing deduction for 2021.

- Businesses also can claim a 100% bonus first year depreciation deduction for machinery and equipment bought used (with some exceptions) or new if purchased and placed in service this year, and for qualified improvement property, described above as related to the expensing deduction. The 100% write-off is permitted without any proration based on the length of time that an asset is in service during the tax year. As a result, the 100% bonus first-year write-off is available even if qualifying assets are in service for only a few days in 2021.

- Businesses may be able to take advantage of the de minimis safe harbor election (also known as the book-tax conformity election) to expense the costs of lower-cost assets and materials and supplies, assuming the costs aren’t required to be capitalized under the UNICAP rules. To qualify for the election, the cost of a unit of property can't exceed $5,000 if the taxpayer has an applicable financial statement (AFS, e.g., a certified audited financial statement along with an independent CPA's report). If there's no AFS, the cost of a unit of property can't exceed $2,500. Where the UNICAP rules aren't an issue, and where potentially increasing tax rates for 2022 aren’t a concern, consider purchasing qualifying items before the end of 2021.

- Year-end bonuses can be timed for maximum tax effect by both cash and accrual basis employers. Cash-basis employers deduct bonuses in the year paid, so they can time the payment for maximum tax effect. Accrual-basis employers deduct bonuses in the accrual year, when all events related to them are established with reasonable certainty. However, the bonus must be paid within 2½ months after the end of the employer’s tax year for the deduction to be allowed in the earlier accrual year. Accrual employers looking to defer deductions to a higher-taxed future year should consider changing their bonus plans before year-end to set the payment date later than the 2.5-month window or change the bonus plan’s terms to make the bonus amount not determinable at year end.

- Sometimes the disposition of a passive activity can be timed to make best use of its freed-up suspended losses. Where reduction of 2021 income is desired, consider disposing of a passive activity before year-end to take the suspended losses against 2021 income. If possible 2022 top rate increases are a concern, consider holding off on disposing of the activity until 2022 might save more in future taxes.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.