April 2021

Tax Talk

A quarterly publication of Bridges & Dunn-Rankin, LLP

Inside this issue:

Dear Clients and Friends,

A lot has happened since the last issue of our newsletter (December 2020). Jon Ossoff and Raphael Warnock each won US Senate seats in the run-off in Georgia, giving the Democratic party control of Congress and the White House, and likely meaning higher tax rates in the near future. In late December, Congress passed the *Consolidated Appropriations Act, 2021*, which, amongst other things, clarified that expenses funded by Paycheck Protection Program (PPP) loans are tax deductible, provided for a 2nd draw of PPP loans, extended and enhanced the employee retention credit (ERC), and provided for direct stimulus payments of $600 per person to eligible individuals. In March, Congress passed the *American Rescue Plan Act of 2021*, the highlights of which include a further extension of the employee retention credit, additional stimulus rebate checks (up to $1,400 per eligible individual), an exclusion from taxable income for certain unemployment benefits, enhanced child tax credits and an enhanced child and dependent care tax credit. Collectively, the Covid-19 stimulus-related Federal legislation enacted over the past 13 months now represents more than $5 trillion in aid.

In late March, under pressure from Congress, the IRS announced that this year it would extend the traditional April 15 deadline to May 17; but only for 2020 individual income tax returns and payments due therewith. Returns (or extensions) for calendar year C-corps and trusts are still due by April 15, as are individual first quarter 2021 estimated tax payments. Most state DORs have quickly followed the IRS' lead, extending the deadline for individual state returns to May 17. The usual September 15 (partnerships and S-corps), September 30 (trusts), and October 15 (individuals and calendar year C-corps) extended due dates are still available.

In this issue, we will summarize the recent tax legislation, profile our newest member, discuss the possible advantage of electing out of the installment sale method, and discuss tax planning magic bullets.

We hope that you will enjoy this issue and gain from it some useful information.

Sincerely,

Kent Bridges

Kent Bridges,
Managing Partner

The Consolidated Appropriations Act, 2021

On December 27, 2020, the *Consolidated Appropriations Act, 2021 (CAA 2021)* was signed into law. Below is a summary of the highlights.

PPP-funded expenses are tax deductible – For most small to midsize companies, the centerpiece of the *CARES Act* (Covid-19 stimulus legislation enacted in March 2020) was the Paycheck Protection Program (PPP), whereby a business could apply for an SBA loan equal to roughly 2½ months payroll and, so long as the proceeds were used for qualifying costs (basically payroll, rent, utilities and mortgage interest, with some limitations), the business could then have that loan forgiven. Congress made clear in the legislation its intent that this would essentially be a tax-free grant. That intent notwithstanding, the IRS issued a notice in April 2020 that it intended to disallow the deduction for expenses paid with PPP funds; which is essentially a backdoor way of taxing the PPP proceeds. In *CAA 2021*, in a big win for businesses, Congress overrode the IRS and made clear that not only is the loan forgiveness not taxable, but also the expenses paid for with PPP funds are tax deductible. Some, but not all, states have followed suit.

2nd Draw PPP – *CAA 2021* provides for a 2nd round of Paycheck Protection Program forgivable loans (up to $2 million per borrower). The rules for this round are, for the most part (with a few exceptions), very similar to the rules for the first round of PPP loans; the most important exception being that in order to be eligible for this 2nd draw your revenue for at least one quarter of 2020 must have been at least 25% less than your revenue for the corresponding quarter of 2019. Originally, the deadline to apply for 2nd draw PPP was March 31, 2021, but Congress has recently extended that to May 31, 2021.

Employee retention credit – Included in the *CARES Act* in March 2020 was the employee retention credit (ERC) whereby an employer (business or nonprofit organization) whose business was partially or fully suspended by orders from a governmental authority due to the Coronavirus or who had a substantial (50%) decline in revenue due to Coronavirus could claim a refundable payroll tax credit of up to 50% of qualified wages paid between March 12, 2020 and December 31, 2020. For employers with 100 or fewer full-time equivalent employees (based on 2019 average), qualified wages included up to $10,000 per employee; regardless of whether they were able to work. For employers with more than 100 full-time equivalent employees, the amount was further limited to being only those employees who were unable to work due to the shutdown. Employers accepting PPP funds were not eligible to claim the ERC. Since the PPP was, in general, more advantageous, the ERC was largely overlooked. *CAA 2021*, however, provides that you can claim the ERC even if you

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Member in the Spotlight—Jackson Fendley

The newest member of Bridges & Dunn-Rankin is Jackson Fendley, a CPA with a BBA in Accounting and a Masters of Accountancy from Auburn University.

Prior to joining Bridges & Dunn-Rankin, Jackson was in the Tax Department of the Big Four firm EY, working in the Private Client Services group, primarily serving private equity backed companies.

Jackson is a member of the AICPA and the GSCPA, and enjoys Atlanta United games, hiking, and Auburn sports.

Bridges & Dunn-Rankin is proud to have Jackson Fendley as a member of our firm.

Jackson L. Fendley, CPA

The Consolidated Appropriations Act, 2021 — continued

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accepted a PPP loan; just not for the same costs. CAA 2021 extends the ERC through June 30, 2021 (later extended to December 31, 2021 by subsequent legislation), reduces the definition of substantial decline in revenue to 20% (beginning with Q4 2020 when compared to same quarter of 2019), increases the credit amount from 50% of qualified wages to 70% of qualified wages (effective 1/1/21), and increases the limit on qualified wages (1/1/21) from $10,000 per employee in total to $10,000 per employee per quarter (with the wage limitation being based on amounts paid each specific individual, not by dividing total wages by number of employees). With these enhancements (including the later extension to 12/31/21), the credit for 2020 and 2021 combined can potentially be as much as $33,000 per employee.

Rebate checks to individuals – Under the *CARES Act* (March 2020), subject to income limitations (phaseout begins at $75,000 for individuals and $150,000 for couples), persons who could not be claimed as a dependent on someone else's income tax return were eligible to receive $1,200 ($2,400 for couples filing a joint return) plus $500 for each child. *CAA 2021* provides for an additional $600 per person ($1,200 for couples filing a joint return) plus $600 per dependent child, based on the same income limitations as those which applied for the first round of stimulus checks.

The American Rescue Plan Act of 2021

On March 11, 2021, President Biden signed into law the *American Rescue Plan Act of 2021* (ARPA). Below is a summary of the highlights.

3rd round of rebate checks to individuals – The *CARES Act* (March 2020) provided for direct payments of up to $1,200 per eligible person (plus $500 per child), and *CAA 2021* (December 2020) provided for another $600 per eligible person (plus $600 per child). *ARPA* provides for an additional $1,400 per person ($2,800 for a couple) plus $1,400 per dependent (including adult dependents). Eligibility is subject to income limitations (phaseout begins at $75,000 for individuals and $150,000 for couples, and singles with income above $80,000 and couples with income above $160,000 are not eligible), and you are not eligible if you can be claimed as a dependent on someone else's income tax return (whether that person actually claims you are not). IRS bases eligibility on your most recently-filed income tax return (with no recapture requirement even if you would be ineligible based on income level the following year), so in some situations (e.g. your 2019 return reflected income below the phaseout threshold, but 2020 return will reflect income above the threshold) it may be advantageous to delay filing your 2020 return.

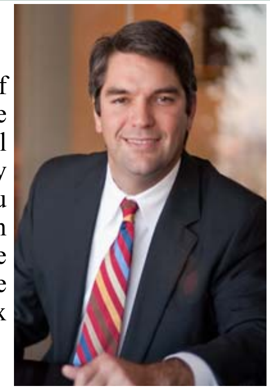
Extension of Federal supplemental unemployment benefit – The $300 per week of Federal supplemental unemployment (in addition to state amount) is extended through September 6, 2021.

Exclusion of unemployment benefits from taxable income – For 2020, households with income of less than $150,000 can exclude from taxable income up to $10,200 of unemployment benefits. The exclusion is available for each spouse if a joint return is filed (i.e. potentially an exclusion on a joint return of up to $20,400 if each spouse received unemployment benefits). To the extent you already filed your 2020 return including the full amount of your unemployment benefit in income (but are eligible for this new exclusion), the IRS intends to issue you a refund (without your having to file an amended return).

Enhanced child tax credits – Prior law provided for a credit of up to $2,000 per child (with phaseout of the credit when income exceeded $200,000 on the return of a single person or $400,000 on a joint return). For 2021, *ARPA* adds an additional $1,000 per child ages 6 to 17 and $1,600 per child under the age 6 (for a total of $3,000 or $3,600 per child) for singles with income below $75,000 or married couples with income below $150,000 (with a phaseout for those above these levels). So, for 2021, you have two different income phaseout ranges; one for the $2,000 credit and one for the additional $1,000 or $1,600. Beginning in July, IRS is to make advanced monthly payments of the increased credit.

Enhanced child and dependent care tax credit – Prior law provided for a partial tax credit for child and dependent care expenses incurred in order to enable the taxpayer to work. The amount of the credit varied based on amount of expenses incurred and level of income, but was limited to a maximum of $1,050 for one dependent or $2,100 for two or more. Under the new rules, the credit can be as much as $4,000 for one dependent or $8,000 for two or more (with computation based on up to 50% of amount expended for the care). The credit is subject to income limitations, with a phaseout for income between $125,000 and $440,000.

Electing Out of the Installment Sale Method: Tax Planning with Hindsight



Brock W. Bullard, CPA

Under the installment sale method, the general rule when you sell a capital asset and will receive one or more payments after the year of sale is that you report on each year's tax return only the gain attributable to payments actually received during that year. This is generally very advantageous, in that it enables you to defer tax and match the payment of the tax with the receipt of the related cash. What happens, however, if tax rates increase?

A special rule permits you to elect out of the installment sale method and report all of the gain on the return for the year of sale. This could result in a significant tax savings if your rate on capital gains will be higher in the year of receipt of payment than in the year of sale (e.g. if, as feared by many, the capital gain rate is significantly increased by legislation enacted later this year). You have up until the due date of your return for a year (including extensions) to make this irrevocable election, so this rule provides an opportunity to do some tax planning with the benefit of hindsight.

Magic Bullets

Often when a prospective client calls us, it is because they have just gotten sticker shock after learning how much they owe with their tax return. Many times, it is because they have high W-2 income and received a significant bonus or stock compensation income during the year upon which their employer only withheld 22% Federal income tax (the required withholding on "supplemental income" below $1,000,000) rather than at their marginal Federal rate of 37%. They feel that they must be missing out on something. Frequently, our response is that we have no "magic bullets" to make the tax on W-2 income go away.

What we do is basic blocking and tackling, which is what we believe wins the long game, rather than trick plays and Hail Marys. With that said, here, in no particular order (and limited by the space constraints of this newsletter), is a brief summary of some of the planning strategies we use; some of which perhaps do come close to being magic bullets.

IRC 1202 exclusion – This one is pretty close to a magic bullet. If you invest in the stock of a qualifying C-corp and hold the stock for at least 5 years, then you can exclude from your taxable income gain on the sale of up to the greater of $10,000,000 or 10x your investment.

Deferral of capital gain into a QOF – If you reinvest capital gain into a Qualified Opportunity Fund, then you can defer taxation of the gain until 2026, permanently avoid tax on a portion of the deferred gain, and potentially permanently avoid tax on any appreciation in value of the investment (assuming held for at least 10 years).

IRC 1031 like-kind exchange – For a sale of real estate which is held for investment or used in a business, so long as you properly structure the transaction (e.g. use a qualified intermediary, identify potential replacement property(s) within 45 days, and close on replacement property within 180 days), you can defer the tax on a gain (potentially forever) by acquiring replacement real estate of an equal or greater value.

Harvesting of capital losses – Capital losses (which can only offset capital gains) can be carried forward indefinitely, but cannot be carried back. Accordingly, it is generally a prudent tax strategy to harvest capital losses whenever you can.

Exclusion for gain on sale of residence – You can exclude from taxable income up to $250,000 of gain ($500,000 for a married couple) on the sale of a home, so long as it has served as your primary residence for at least 2 of the immediately preceding 5 years.

401k, pension plan, traditional IRA and Roth IRA – These vehicles can be used to shelter earned income from current tax, and/or enjoy a lengthy or permanent deferral of tax on that income and/or the future investment earnings thereon, and generally enjoy creditor protection. A year of low income when itemized deductions or standard deduction and low-rate brackets may be wasted is an ideal time to consider converting traditional IRAs to Roth status. Also, a strategy of doing "backdoor" Roth contributions (nondeductible traditional IRA contribution followed by conversion to Roth status) can be effective for those who otherwise do not qualify for Roth contributions (but who do not have any zero or low basis traditional IRAs). Once you are age 72, you are required to take a certain minimum distribution (RMD) from your IRAs each year or otherwise face a draconian penalty. Deferring taking any distributions until you are age 72 is not always the best strategy, as there may be years between age 59 (the earliest at which you can generally take without penalty) and age 72 in which you can take some distributions at a lower tax rate than that which will apply once you begin your RMDs. Also, for those who are philanthropic, distributions made directly to a charitable organization can satisfy the RMD requirement.

Charitable – Tax law encourages and rewards charitable giving, which can include cash donations, gifts of appreciated property (which generally magnify the tax savings), gifts to a charitable remainder trust (which enable you to avoid incurring immediate tax on the sale of appreciated property and retain an income stream for life), gifts to a private foundation or donor advised fund (which provide an immediate income tax deduction to match the timing of a large amount of income while providing the donor many years to make transfers to charitable organizations), gifts of an IRA or from an IRA, and the granting of a conservation easement (although caution is in order here, as the IRS is heavily scrutinizing conservation easements based on perceived abuse in this area).

Relocation to a tax-friendly state or Puerto Rico – Most states subject their residents to tax on their worldwide income, whereas non-residents pay tax only on income sourced to the state. State income tax rates on individuals can range from 0% to 13%. Accordingly, substantial savings can often be generated by establishing domicile in a state with no state income tax (while minimizing contact to the extent possible with those states with an individual income tax). Becoming a bona fide resident of Puerto Rico can potentially enable you to avoid not only state income tax, but also Federal income tax.

Tax credits - There are various tax credits which can be utilized to minimize state income tax. Some must be generated by a business entity (e.g. the Georgia research credit), some can

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Magic Bullets — continued

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essentially be purchased (e.g. the Georgia low-income housing credit and film credit), and others are based on taking some action which the government is encouraging (e.g. the Georgia credit for donations to Student Scholarship Organizations). Similar to the state level (but generally not transferrable), Federal tax rules provide a plethora of tax credits for both businesses and individuals designed to encourage and reward behavior Congress has deemed desirable.

Children and education – While generally subject to limitation based on income level, the tax code provides deductions and credits associated with having children, paying for daycare, and education. Section 529 plans (which are not subject to limitation based on income) permit investment gains to permanently escape tax, so long as the funds are used for qualified education.

Positioning of investments – Investments which are likely to produce ordinary income and short-term capital gains (e.g. bonds, REITs and actively-traded mutual funds) should generally be in qualified retirement plan accounts, while investments likely to produce non-taxable income (e.g. muni bonds) or income taxed at favorable rates (e.g. stocks and index funds) should be in your taxable accounts.

Incentive stock options (ISOs) - ISOs hold out the promise of being able to potentially convert what would otherwise be ordinary income into long-term capital gain. However, because the bargain element is an "alternative minimum tax" (AMT) adjustment on the date of exercise, the AMT often eliminates much of the hoped-for benefit. A tax year in which you will not be in the AMT represents an opportunity to exercise some ISOs at no tax cost. Also, if you exercise ISOs and sell in the same tax year, then the AMT issue goes away. Accordingly, we typically advise our clients who want to exercise and hold ISOs to do so early in the year, giving us almost a full year to watch the stock price and to sell the stock before year end if necessary in order to cure the AMT problem.

AMT credit for minimum tax paid in earlier years – Alternative minimum tax (AMT) which results from timing differences (e.g. depreciation and exercise of ISOs) can be carried forward and claimed as a tax credit in a year in which you are not in the AMT.

Deferral/acceleration strategies and rate arbitrage - In an era of very low short-term interest rates, we do not get too excited about short-term deferral strategies. Long-term deferral strategies like 1031 exchanges or the continuing year after year deferral from adoption of cash method are another story. True *permanent* tax savings, however, tend to come when you can get rate arbitrage (e.g. take a deduction in a high marginal rate year and the related income in a low marginal rate year).

Installment sale method – Under the installment sale method, for sales of capital assets, you can generally defer tax until the year of receipt of payment; or you can elect to report all of the gain in the year of sale if beneficial to do so.

IRC 469(c)(7) for real estate professionals – Real estate professionals can often avoid the passive activity loss limitation rules with a 469(c)(7) election.

Estate planning – Significant family wealth can be preserved by setting up family partnerships and trusts early and moving assets into them before they appreciate.

Choice of entity - One of the most significant decisions you face when starting a company is deciding through which type of legal entity you will operate the business; and for existing businesses, an evaluation should be made periodically as to whether the type of entity you are using is still the best choice for you.

Selection of accounting methods – New businesses can, within certain limitations, select the tax accounting methods (e.g. cash or accrual) which are most beneficial for them; and existing businesses have some latitude to later change their accounting methods.

Optimizing the "qualified business income" deduction –This deduction is generally limited to the lesser of 20% of K-1 income or 50% of the owner's share of W-2 wages paid by the business. The deduction can often be maximized by choice of entity and level of compensation paid to the owners.

S-corp and LLC basis and at-risk limitations – Sometimes it is advantageous to make sure you have sufficient basis to deduct K-1 losses or avoid gain from distributions, and other times it is better to do the opposite.

Bonus first-year depreciation and Section 179 expense – Special rules can permit an immediate tax deduction for 100% of the cost of fixed asset purchases.

Employee stock ownership plan (ESOP) – For those who want to have broad-based employee participation in ownership of the company, an ESOP can be a very tax effective way to accomplish this; especially if the company is a C-corp (where the gain rollover provisions apply for a selling shareholder).

Get appointed to a U.S. Cabinet position – Persons appointed to a high-level government position (e.g. the U.S. Cabinet) who get a certificate of divestiture to avoid conflict of interest can elect to defer the gain from the sale of the asset into replacement property (IRC 1043). We haven't actually done this one yet, but it seems like a great way to diversify your portfolio at no tax cost (and may be a real magic bullet).

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