

# Unlocking Cash During Covid... Using TAX!!!!

September 23, 2020

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC, an SEC-registered investment advisor



Create Opportunities

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# New TAX LAWS 2020





# Let's make it RAIN!!!

- Innumerable tax opportunities to **HELP YOU!**





# Qualified Improvement Property (QIP)

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# What Is Qualified Improvement Property (QIP)

- Interior improvement to non-residential building
- Placed in service after building first placed in service
  - 1 day is OK (Rev. Proc. 2017-33)
- Not an enlargement, elevator, escalator or structural
- Originally – 50% bonus on 39-year improvements
  - 2016 and 2017



# QIP – TCJA Changes...



- Definition of QIP moved in Sec. 168
  - From type of qualified property for bonus
  - To specific classification of property
- Replaced three special classes of 15-year property
  - QLHIP, QRP, QRIP
- However, QIP not added to list of 15-year property
  - Nicknamed **“Retail Glitch”**
- Defaulted to 39-year property, not bonus eligible

# QIP – CARES Act Fixes Glitch!!!



- Added QIP to list of 15-year property
  - Making it **bonus eligible**
- Correction ***retroactive to January 1, 2018***
- Improvement must be “made by the taxpayer”

***Amend Returns and Take Advantage in 2020!!!***





# Net Operating Losses (NOLs)

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# A Little NOL History...

- Pre-TCJA
  - 2 years back, 20 years forward
- TCJA
  - NOL carrybacks: **Repealed**
  - NOL carryforwards: **Indefinite**
  - **BAD NEWS**: NOL Carryover can only offset **80%** of taxable income



# Cares Act – NOL Changes

- Provides a 5 year carryback of NOLs for losses incurred in 2018, 2019, or 2020
- **Suspends 80%** of TI NOL Limit
  - NOL can offset 100% of Taxable Income
- Pass-through business owners can use NOLs to offset non-business income above the previous \$500k limit (\$250k for MFS)

***Short Window for 2018 – 2020 NOLs only...Carry those losses  
BACK!!!***



# Maximizing NOL

- “Big bath” in either ‘19 or ‘20
  - QIP – amend vs. 3115
  - Accelerate equipment purchases into ‘20
  - Cost Seg., 179D, inventory, etc.
  - Method scrub (prepaids, accruals, deferreds, 263A)
  - Retirement contributions
  - Bad debt and other loss harvesting



# Summary of NOL Rules

Year of loss	C/B period	C/O period	% of TI offset with loss	Excess Business Loss
Pre-2018 (Pre TCJA)	2 years	20 years	100%	N/A
2018-2020	5 years	Indefinite	100% (80% for losses carried to 2021 and beyond)	N/A
2021 and later	None	Indefinite	80%	Limited to \$250k/\$500k



## Business Interest Expense Limitation...

**More generous under CARES Act!!!**



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# CARES Act Changed Adjusted Taxable Income (ATI) limit for Interest Expense Limit

- Was your interest expense deduction limited on your 2019 tax return?
- TCJA limited interest expense deduction to 30% of ATI
- CARES Act moved it up to 50%!!!
  - Opportunity to amend 2019 and reduce tax!
  - N/A for partnerships in '19
    - ◇ Partners can use 50% on '20 return



# Another Change in Calculation of ATI for Interest Expense Limitation

- Get to add back depreciation to taxable income for calc of ATI, thereby allowing more deduction
  - **BUT**...Add back did not include depreciation in COGS
- Final Regs allow add back of COGS depreciation

**Amended 2018 & 2019 return opportunity!**





# For Accrual Basis Taxpayers...

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# Accelerate Compensation & Bonus Deduction


- Deduct accrued compensation that is fixed, determinable and paid within 2.5 months following the tax year end (March 15<sup>th</sup> for Calendar YE)
  - IOW, **deduct an expense you don't pay 'til next year!**
- Related Party Rule:
  - Business deduction must match the gross income inclusion of the related taxpayer
  - E.g., bonus paid to a cash-basis, related party after year end is deductible in the year paid (i.e., next tax year)



# Write-off Accounts Receivable

- Accrual-basis taxpayers should evaluate accounts receivable and write-off uncollectible accounts!

**Direct  
Write-Off Method**



General Journal				Accounts		Trial Balance
Date	Accounts	Debit	(Credit)			
2/17	Bad Debt Expense	9,000		Cash-Checking		100,000
	Accounts Receivable		(9,000)	Accounts Receivable		1,200,000
				Allowance for Doubtful Accoun		0
				Accounts Payable		(10,000)
				Capital		(912,000)

# Defer Advanced Payments under Section 451(c)

- Advanced Payments-General Tax Rule:
  - Taxpayer using the accrual method who receives advanced payments, must:
    - ◇ Include advance payment in income in year received (Full Inclusion Method), or
    - ◇ **Include the advanced payment (or portion) in gross income in the taxable year of receipt to the extent included in revenue in its AFS, and include the remaining amount in gross income in the next taxable year (Deferral Method)**
  - If currently using the Full Inclusion Method taxpayer may want to make an **accounting method change to the Deferral Method**.





# Other Items for Accrual Basis Taxpayers...

- Change to **Cash Method** of Accounting (if qualified & beneficial)
- **Deduct accrued expenses** that are fixed, determinable, and paid within 8 ½ months after year end (9/15 for calendar year Entity)
  - Assumes taxpayer has recurring items exception in place
- **Payment equals economic performance liabilities**: allows certain prepaid expenses to be deducted in the year paid, such as prepaid insurance, when paid (Reg. § 1.461-4(g))
- **3.5 Month Rule**: Deduct prepayments for services received within 3.5 months of year end for accrual basis taxpayers (4/15 for calendar year Entity)





# For Cash Basis Taxpayers...

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# Other Items for Cash Basis Taxpayers

- **12 Month Rule for Prepaid Expenses:** deduct certain prepaid expense such as insurance with terms of 12 months or less. (Reg. §1.263(a)-4(f))



# Inventory Opportunities!!!

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# UNICAP - New Opportunity from Final Regs.

- New Items from Final Regulations (Applicable to 2019 Calendar Yr. Taxpayers):
  - **Modified Simplified Production Method (MSPM) is a new simplified method for producers**
    - ◇ MSPM allows taxpayers to allocate costs between pre-production (Raw Materials & Purchased Goods) and production (WIP and Finished Goods) activities versus single allocation to ending inventory.
  - New treatment of “negative” adjustments
    - ◇ Unfavorable Book-Tax adjustments resulting in a reduction to Section 263A costs
  - Negative adjustments only permitted for taxpayers:
    - ◇ Using Modified Simplified Production Method (MSPM),
    - ◇ Using Simplified Resale Method (SRM), or
    - ◇ Small Taxpayers (<\$50M Gross Receipts) using Simplified Production Method (SPM)
  - Not available for large taxpayers (>\$50M Gross Receipts) currently using SPM
  - See Rev Proc 2018-56 related to Accounting Method Change Information. (Accounting Method Change #237)



# Inventory Valuation: Subnormal Goods

- Tax regulations make a distinction between “normal” and “subnormal” goods (Reg. §1.471-2(c )
  - Normal goods are valued under general LCM rules
  - Subnormal goods are provided special rules for determining value.
- Subnormal goods are goods that a taxpayer has an inability to sell or use because these goods are **damaged, have imperfections, have shop wear, out of style, odd, broken or some other issue.**
  - Goods must be defective and not just slow moving or inactive.
- When goods are deemed subnormal the taxpayer may **value these goods at net realizable value (NRV).**
  - ◊ Net realizable value is equal to the selling price less costs to dispose of the goods.
- Methods for determination of selling price:
  - Actually offer goods for sale during a period ending not later than 30 days after inventory date.
- Accounting Method Change #137.





# Inventory Valuation: Lower Cost or Market (LCM)

- There are two acceptable inventory valuation methods:
  - Cost
  - Lower of Cost or Market
- Under LCM a taxpayer's replacement/reproduction cost for goods is considered to be market value.
  - We are not permitted to take a deduction for inventory allowances or reserves.
- BUT...Under LCM rules taxpayer is allowed a write down and reduce the carrying value of inventory for tax purposes if valued at the current bid price for the goods at the time of the inventory count.
  - Bid Price is the replacement cost
  - Replacement cost write-downs could apply to abnormal goods or goods that are unique and unusual design (i.e. custom produced items).





# Turn Disaster into Dollars!!!

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# Disaster Loss Election

- Strong year last year? Horrible year this year?
- Deduct loss in taxable year **before** disaster year
  - Harvest losses NOW by reducing 2019 tax with 2020 losses
- Which losses?
  - Inventory loss (adjust opening inventory of disaster year)
  - Cancelled events
  - Stock investments?
  - Real property?
- Realized loss
  - Not otherwise compensated





## Other Opportunities...

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# Retirement Contributions

- Pre-tax contributions
  - Watch for limits (e.g., SEP IRA)
- Roth IRA conversion?



# Worthless Stock Deduction

- Take loss for stock that becomes worthless during year







# Paycheck Protection Plan (PPP) – Tax Related Issues

Chris Hesse

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# Paycheck Protection Program Tax Issues

- Loan forgiveness not taxable
  - Not an IRC provision
  - Section 108 not implicated
- What about § 265?
  - Nondeductibility of expenses related to tax-exempt income
  - IRS says Sec. 265 applies



# Timing of Loan Forgiveness

- Client incurs qualified PPP expense in 2020
- Client does not get loan forgiveness until 2021
  - Deduct expenses in 2020, and pick up income in 2021!





# COVID-19 Tax Credits

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## Two Acts with Refundable Credits...

1. Families First Coronavirus Response Act (FFCRA)
  - Credit for mandatory paid leave (2 Credits under FFCRA)
    - ◇ Emergency Paid Sick Leave (E-PSL)
    - ◇ Emergency FML (E-FML)
    - ◇ Employee could use both E-PSL & E-FML
2. CARES Act Employee Retention Credit



# Who Qualifies for FFCRA Credits?

- Employers with fewer than 500 employees must comply with mandatory payments
  - Exemption: some businesses with fewer than 50 employees
- ALL employees are eligible (FT, PT, Temporary)
  - On payroll for least 30 days
- Same employers qualify for FFCRA Credits



# FFCRA - Emergency Paid Sick Time (PST)

1. Employee is subject to a governmental quarantine or isolation order related to COVID-19
2. Employee has been advised to self-quarantine by health care provider due to COVID-19
3. Employee is experiencing symptoms of COVID-19 and seeking medical diagnosis
4. Employee is caring for an individual subject to a governmental quarantine order or HC provider recommended
5. Employee is caring for minor child(ren) due to school or care location closure due to COVID-19
6. Employee is experiencing any other “substantially similar condition” specified by the HHS Secretary

## 1<sup>st</sup> Credit: Emergency Paid Sick Leave (E-PSL)

If employee qualifies, the employer must pay:

- 80 hours PSL for FT employee
- At the employee's regular rate of pay or minimum wage
- Credit Amount:
  - Capped at \$511 per day and \$5,110 total (caring for self)
  - Capped at \$200 per day and \$2,000 total (caring for others – reasons 4, 5, & 6)





## 2<sup>nd</sup> Credit: Emergency Family & Medical Leave (E-FMLA)

- 12 weeks of leave for employees who cannot work (or telework) to care for minor child(ren) because of school/care closure
  - **Online instruction considered closure**
  - If employer agrees, can be taken intermittently
- First 2 weeks unpaid (can use PST or other PTO)
- Credit Amount
  - 2/3 of regular rate of pay, capped at \$200/day and \$10,000 total



## FFCRA Tax Credits Recap...

- Available for both PSL & E-FMLA
- Refundable
- Dollar-for-Dollar
- Health insurance costs also included
  - Except it is not included for the self-employed



# Who Qualifies for CARES Act Employee Retention Credit?

Operations fully or partially suspended due to COVID-19

Gross receipts < 50% of same quarter in prior year (until gross receipts > 80%)

# How Much is the Employee Retention Credit?

- 50% of first \$10K of comp (incl. health benefits) paid from 3/13/20 to 12/31/20
  - Per employee
- ER ≤ 100 EE: comp paid to all EE during qualified situation
- ER > 100 EE: only comp paid to out-of-work EE
  - Only for Full Time Employees
- Credit is refundable!

**\*\*Not available if ER uses paycheck protection loan\*\***





## Client Opportunity Assessment Tool (COAT)

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## COAT 2.0 – Key Concepts

- Supports customized “Idea Generation & Planning”
- Brings together “Content” and “Strategy”
- Valuable tool for Year End Planning



# How Does it Work?

- Filter for what is relevant, useful, and important to **YOU!**
- Generates “Suggested Opportunities”
  - Based on Gross Income
  - Entity Type
  - Industry

## Screen Shot...

Assessments Opportunities Admin

+

Status: Active

Client Name: ABC Manufacturing

Entity Type: Partnership

Industry: Manufacturing & Distribution

Revenue: Below \$26 million

Tax Year: 2020

☐ Show Inapplicable Opportunities

Collapse All

Expand All



Visible Opportunity

Description

Entity Type

Partnership

Industry

Manufacturing &amp; Distribution

- Capital gain vs. Ordinary Income >
- Deductions >
- ✓ Self-employment tax >
- Credits >
- Tax Compliance >
- COVID-19 Tax Relief >
- Helpful Reminders >
- Accounting Methods >
- Business and Organization Operation Issues >
- Sales, Use and Other Local Tax (non-income tax) >



Visible Opportunity Description Entity type Partnership Industry Manufacturing & Distribution Link

## Capital gain vs. Ordinary Income



### Understanding "Carried Interest" planning

Investment fund managers granted profits interests for providing services to funds organized as partnerships ("carried interests") have been taxable on distributions at preferential capital gain rates even though income from providing services is generally taxable at ordinary income rates.

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Agriculture & Cooperatives, Construction, Financial Institutions Group, Health Care, Higher Education, Manufacturing & Distribution, Private Equity, Professional Services, Real Estate, Retail, Technology, Transportation & Logistics

[BNA Sec. 1061 Carried Interest Rule - Proposed Regulations 8.3.2020](#)

## Deductions



### Personal Property Included in Building's Cost Segregation Study

A cost segregation study is an analysis of the assets constructed, acquired or renovated to properly allocate costs to the appropriate assets, for the intent of allocating as much cost as possible to shorter lived Section 1245 (generally tangible, personal) property.

C, S, I, P

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[Checkpoint - Cost Segregation inclusion of personal property](#)



### Final Business Interest Limitation Rules Present Opportunities

Deduction for net business interest has been increased to 50% (previously 30%) of adjusted taxable income in 2020. Any interest that is not deductible can be carried forward and used in later years if the organization generates enough income.

C, S, I, P

Agriculture & Cooperatives, Construction, Financial Institutions Group, Health Care, Higher Education, Manufacturing & Distribution, Private Equity, Professional Services, Real Estate, Retail, Technology, Transportation & Logistics

[CLA Article by John Werlhof](#)





The IRS recently issued guidance that provides relief and clarity on the business interest limitation. Take advantage of the new rules to deduct more of your business interest.

#### TAX REFORM

## Final Business Interest Limitation Rules Present Opportunities

*By John Werthof*  
8/17/2020

### Key insights

- Congress offset part of the cost of the recent tax cuts with limits to the amount of interest certain businesses can deduct.
- The section 163(j) limitation applies to all business entity types and is generally applied at the entity level.
- Final IRS rules allow you to increase your adjusted taxable income for cost of goods sold depreciation, which substantially increases the amount of the limit for many manufacturers.
- If your business uses a calendar year end, you will need to apply the final IRS rules beginning in 2021.

# Schedule YOUR COAT Assessment TODAY!!!!



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# Create Opportunities

CLA exists to  
create opportunities —  
for our clients, our people,  
and our communities.