GROWERTALKS

Features

12/1/2019

Getting a Head Start on Tax Savings

Mark E. Battersby

Good tax planning is based on your current versus potential future earnings or profits. For those growers whose taxable earnings will potentially be lower next year, tax planning is very simple: defer any income possible, pushing it onto next year's lower tax bill.

In addition to deferring income until next year when the tax bill, if not the tax rates, may be lower, it might be more valuable to accelerate deductions on the current year's tax bill. Consider, as one example, prepaying some deductible expenses.

Prepayments

Those seeking extra business deductions before the end of the year can prepay some expenses, such as business insurance, rent on equipment and lease payments on business vehicles. The general rule is that expenses for a future year cannot be prepaid and deducted from the current year's tax bill.

An expense paid in advance can only be deducted in the year to which it applies. Fortunately, there's an exception: the "12-month" rule allows you to deduct prepaid expenses in the current year if it's for a right or benefit that extends no longer than 12 months or until the end of the tax year after the tax year in which the payment is made.

The 12-month rule can apply to business insurance premiums, licenses, rents and leases, as well as to payments for terminating business contracts. It may not, however, be used for interest payments, loans or other financial interests or for purchases of equipment, fixtures or other long-term capital assets.

Bottom-line—whether prepaying expenses makes sense depends on a comparison of this year's predicted tax bill with those expected in future years. If income is expected to go up substantially next year, instead of prepaying expenses, maximizing next year's deductions might be the best option.

Creating larger deductions

The 2017 Tax Cuts and Jobs Act (TCJA) increased the write-offs for certain types of business equipment. These accelerated depreciation deductions allow you to immediately write-off more of the cost of business equipment purchased during the year to produce a lower bill when tax returns are filed.

The TCJA increased the bonus depreciation deduction for expenditures made during the year for business assets with a useful life of 20 years or less. With bonus depreciation, 100% of the cost of equipment, computers and other business assets with a life of 20 years or less and placed in service during the 2019 tax year can be written-off.

The IRS also recently released guidelines (Revenue Procedure 2019-33) that allow you to make a "late election," changing their mind about earlier treatment of the bonus depreciation deduction. Everyone who took advantage of the 100% bonus depreciation can now opt out—or if they earlier chose not to take bonus depreciation, they can now retroactively tax advantage of the full 100% write-off.

However, since opting out or in is available for tax years between 2017 and 2018, it should be kept in mind that you can elect to deduct only 50% bonus depreciation, instead of the full 100% for expenditures prior to September 27, 2017.

Either way, to make this late election, filing an amended tax return or a Form 3115, Application for Change in Accounting Method, is the proper route. And also keep in mind that bonus depreciation is automatic—to opt-out means making a specific choice.

Section 179 expensing and more

The Section 179 write-off for deducting similar expenditures for the tools, equipment or other business assets placed in service during the tax year has been around for a while. The TCJA increased the amount of the Section 179 first-year expensing write-off to $1 million (up from an inflation-adjusted $510,000). What's more, the ceiling after which the write-off is reduced, dollar-for-dollar, now kicks in only when expenditures for expensing-eligible property exceeds $2.5 million (up from $2,030,000).

Is it better to take the Section 179 write-off or the bonus depreciation deduction? Remember, unlike bonus depreciation, the Section 179 first-year expensing deduction cannot result in a loss for the operation.

More potential savings

Every grower can get a tax credit, a direct reduction of the tax bill rather than a deduction from the amount that tax bill is based on, for investing in specific energy-saving improvements and projects. The amount of the tax credit is:

• 30% for solar, fuel cells, small wind turbines, etc.

• 10% for geothermal, microturbines, and combined heat and power

What percentage of a vehicle used in your business or by you is attributable to business usage? The IRS allows two ways to calculate the deduction: First, there's the actual expense to which the percentage is applied to create the business auto expense deduction; or tracking the actual mileage for business purposes and using the 54.5 cents per mile standard write-off.

Income now and later

The general rule for cash-basis businesses is that income doesn't have to be reported until the year cash is received or a check is in hand. The cash method of accounting used by many small businesses allows the business to micro-manage the operation's 2019 and 2020 taxable income in order to minimize taxes over both years.

A business operating on the cash basis for tax purposes and anticipating 2020 profits higher than in previous years may want to defer revenue to reduce 2019's taxable income. Consider billing late in December or delaying the delivery of certain products or services until January.

Alternatively, if your business is expected to be more profitable next year than in 2019, accelerating cash collection before December 31 would allow those amounts to be taxed at a lower rate.

Records

The purpose of records is to serve as proof should it be demanded by the vigilant IRS. Plus, good records will help monitor the progress of the business, prepare its financial statements, identify sources of income, keep track of deductible expenses and aid in preparation of the annual tax returns. And the best time to assemble those records is now, before the end of the tax year.

With few exceptions, the tax laws don't require any special kind of records, so identifying the business records that should be kept is the first step. Proving income is pretty straightforward, keeping in mind that if there's any doubt, the IRS will often go with your bank deposits.

Expense records are important for deductions and lowering taxable income. Here, cancelled checks may not always do the trick, as IRS auditors want invoices, bills and contracts explaining those cancelled checks. Expenditures for business assets such as equipment, office furniture and other big-ticket items should be documented with contemporaneous documentation.

Giving it away for tax savings

The end of the year is the traditional time for employee bonuses, gift-giving and parties. In addition to the tax deduction for these expenses, you'll often benefit from customer and/or employee's goodwill.

Employee bonuses are usually considered deductible business expenses. However, bonuses to sole proprietors, partners and limited liability (LLC) members aren't deductible because the IRS considers them to be self-employed. Holiday gifts as well as employee parties are often tax deductible so long as they aren't routinely/frequently given and are for the purpose of promoting goodwill.

Planning before year-end

As the end of the tax year approaches, several general rules can help guide you to real tax savings—savings that will be consistent, year-after-year:

• **Don't spend money simply to reduce that tax bill.** After all, $1 spent does not equal $1 worth of tax saved or create a $1 deduction. Also, keep in mind that if those accelerated deductions result in a net operating loss (NOL), it can now be used only to offset tax bills down the road—there's no longer a NOL carryback.

• **Know thy accounting method.** Most tax strategies work best for cash-basis taxpayers. Accrual-basis growers report all income in the year it's earned and all expenses in the year they're incurred—so just because your business is paying for a 2020 expense in 2019 doesn't always result in an immediate deduction on the 2019 tax return.

• **Worker classification matters.** Every business must correctly determine whether workers are employees or independent contractors. Independent contractors aren't, of course, subject to withholding, making them responsible for paying their own income taxes, plus Social Security and Medicare taxes.

Once the work is done and the alternatives tested, do you choose an aggressive approach or a safer, more conservative approach to tax savings? Above all, make sure you're actually spending money and not just moving it around. While it's almost always recommended, few growers get their tax professionals involved well before the end of the tax year. Without planning now, how can anyone hope to know whether income deferral or accelerated write-offs will be of the most help in reducing this year's tax bill—and the tax bills in future years? **GT**

Mark E. Battersby is a freelance writer who specializes in business finance. He can be reached at mebatt12@earthlink.net.