



EBL, Depreciation, 199A and Deductible Meal Expenses

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Wipfli Tax Update 2021

- Topics to be covered:
 - ▶ Sec. 461(l) Excess Business Loss – Refresh and 2021 Changes
 - ▶ Depreciation
 - Changes to Residential Rental Property ADS Lives – RPToB Only
 - Cost Segregation Studies and Bonus Depreciation Tax Strategy
 - ▶ Sec. 199A Deduction – Year of Sale Tax Considerations & Strategies
 - ▶ Deductible Meal Expenses

Excess Business Loss Limitation - Refresh and 2021 Changes

- Refresh
 - ▶ The Excess Business Loss (EBL) limitation was introduced by TCJA under new Sec. 461(l)
 - ▶ Applicable to all noncorporate taxpayers
 - ▶ Net business losses limited to \$250,000 (\$500,000 MFJ), adjusted for inflation
 - ▶ Ordering rule for deduction limitations
 - Basis limitation
 - At-risk limitation
 - Passive activity loss rules
 - EBL

Excess Business Loss Limitation - Refresh and 2021 Changes

- Refresh (continued)
 - ▶ Excess business losses carried forward to subsequent tax year as an NOL
 - Not subject to the EBL limitation again in that year
 - But they are subject to the 80% NOL limitation
 - ▶ CARES Act temporarily suspended the EBL limitation for 2018 – 2020 tax years
 - Retroactive for 2018 – 2019
 - Required taxpayers with previously-suspended EBL limitations to amend their prior year tax returns to remove the limitation
 - May have resulted in creation or increase of existing NOL in the amended year, requiring a carryback of the NOL under the CARES Act's 5-year carryback provision
 - Prospective for 2020

Excess Business Loss - Refresh and 2021 Changes

- 2021 changes
 - ▶ The EBL limitation is back for 2021 tax year
 - ▶ W-2 wages are EXCLUDED from the calculation of business income or loss
 - TCJA Blue Book vs IRS Alert vs Form 461
 - CARES Act clarified
 - Increases likelihood of taxpayers having an Excess Business Loss limitation
 - ▶ Business capital gains and losses
 - Another area of confusion
 - CARES Act clarified
 - DO take into account the lesser of (a) business capital gain net income or (b) all capital gain net income
 - Do NOT take into account capital losses

Changes to Residential Rental Property ADS Lives – RPToB Only

- Background:
 - ▶ A taxpayer that is subject to the 30% business interest limitation under Sec. 163(j) could make the real property trade or business (RPToB) election to avoid the limitation
 - ▶ “Price” for making that election is that all real property and QIP owned by the taxpayer had to be depreciated using ADS depreciation, rather than MACRS
 - ▶ ADS depreciation
 - Nonresidential property – 40 years SL
 - Residential rental property
 - Placed in service prior to 2018 – 40 years SL
 - Placed in service after 2017 – 30 years SL
 - QIP – 20 years SL and no bonus

Changes to Residential Rental Property ADS Lives – RPToB Only

- Consolidated Appropriation Act
 - ▶ The ADS life for residential rental property was changed to 30 years, regardless of when the property was placed in service BUT this change only applies to *taxpayers who are required to use ADS depreciation because they made the RPToB election*
- Opportunity #1
 - ▶ Taxpayers with residential rental property placed in service before 1/1/2018
 - ▶ That made the RPTB election on their 2018, 2019, or 2020 tax return
 - ▶ That were not required to utilize the ADS method for any reason other than their RPToB election
 - ▶ That depreciated that property using 40-year life rather than 30-year life

Changes to Residential Rental Property ADS Lives – RPToB Only

- Actions required for opportunity #1
 - ▶ File a Form 3115, *Application for Change in Accounting Method*, using DCN #88
 - If a taxpayer already filed Form 3115 to change from a 40-year life to a 30-year life under Rev. Proc. 2019-43, using DCN #7, and did so prior to 6/17/21, that prior filing will be respected
 - ▶ File an amended tax return or AAR
 - If the taxpayer used the impermissible 40-year life on two or more previously-filed tax returns, the amended return or AAR for the election year must be filed by 4/15/22 and amended returns or AARs must be filed for subsequent years
 - If the taxpayer only used the 40-year life on one previously-filed tax return, the amended return or AAR must be filed prior to the tax return for the subsequent tax year

Changes to Residential Rental Property ADS Lives – RPToB Only

- Actions required for opportunity #1
 - ▶ Special rules for BBA partnerships
 - ▶ Reminder – BBA partnerships generally cannot file amended returns
 - ▶ Rev. Proc. 2021-29
 - Allows BBA partnerships to file amended tax returns for years beginning in 2018, 2019 or 2020 to change from 40-year to 30-year life for residential rental property
 - Must have filed the return being amended prior to 6/17/21
 - The amended return had to have been filed by 10/15/21
 - Amended return could include not only this change, but any other adjustment the partnership was allowed to make under the Code

Changes to Residential Rental Property ADS Lives – RPToB Only

- Opportunity #2
 - ▶ Taxpayers who have not yet made the RPToB election to avoid the application of the 30% business interest limitation
 - Not previously subject to Sec. 163(j)
 - Previously subject to Sec. 163(j) but “price” to elect out (using RPToB election) was too high under the rule requiring them to use a 40-year ADS life for their nonresidential real property placed into service prior to 2018

Cost Segregation Studies & Bonus Depreciation Tax Strategy

- Current tax reform discussions in Washington include proposals to:
 - ▶ Increase the top tax rate on individuals, trusts, and estates from 37% to 39.6%
 - ▶ Impose a 3% tax surcharge on high-income taxpayers
 - ▶ Expand the income base subject to the 3.8% net investment income tax (NIIT)
 - ▶ Limit the qualified business income deduction under Sec. 199A
 - ▶ Make the limitation on the deduction of business losses permanent and change the treatment of loss carryovers unfavorably
 - ▶ Increase the corporate tax rate from a flat 21% to a graduated system ranging from 18% to 26.5%

Cost Segregation Studies & Bonus Depreciation Tax Strategy

- These proposals, if they become law, will significantly impact tax depreciation strategies for affected taxpayers
- In an environment of increasing tax rates, the general strategy is to accelerate income and defer deductions
- Taxpayers have flexibility when it comes to the timing of depreciation deductions for income tax purposes
 - ▶ Cost segregation studies
 - In year property is placed in service
 - In a later year using a “catch up” Form 3115

Cost Segregation Studies & Bonus Depreciation Tax Strategy

- Taxpayers have flexibility when it comes to the timing of depreciation deductions for income tax purposes (continued)
 - ▶ **Sec. 179D studies**
 - In year property is placed in service or a “catch up” in a later year using Form 3115 (not available to designers who are claiming a Sec. 179D deduction that was assigned to them by a governmental entity)
 - ▶ **Bonus depreciation**
 - Can elect out of bonus on a class-life by class-life basis

Sec. 199A Deduction – Year of Sale Tax Strategies

- Background

- ▶ Individuals, trusts and estates can claim a deduction of up to 20% of their Qualified Business Income (QBI)
- ▶ Limitations on deduction
 - Taxable income (excluding capital gains)
 - Nature of trade or business activity (Specialized Service Trade or Business or not)
 - Taxpayer's share of business's W-2 wages
 - Taxpayer's share of business's Unadjusted Basis Immediately After (UBIA) of depreciable capital assets held at the end of the year
- ▶ By keeping the Sec. 199A rules top of mind when assisting a client with negotiations for the sale of their business, a tax advisor can ensure that the calculation of potential after-tax cash in the client's pocket is not only correct, but also maximized

Sec. 199A Deduction – Year of Sale Tax Strategies

- Carryovers
 - ▶ Don't forget to reflect carryover items, including Sec. 199A losses from prior years, in calculations
 - ▶ Confirm carryovers reported in the tax software are correct
- Stock versus asset sale
 - ▶ A proposed stock sale may evolve into an asset sale/Sec. 338(h)(10) election
 - ▶ Need to understand incremental tax cost to seller that may become part of a price increase negotiation
- Taxable income component
 - ▶ Careful if taxpayer has carryover losses or other current year loss activities offsetting their transaction gains

Sec. 199A Deduction – Year of Sale Tax Strategies

- SSTB
 - ▶ If taxpayer was able to claim Sec. 199A deduction on SSTB income in prior years due to their income being low enough, that may not be the case in the year of the sale due to income spike
- Maximizing wage limitation component
 - ▶ Close sale at end of current tax year rather than the beginning of subsequent tax year
 - ▶ Consider providing owner bonuses, so long as they can be justified as reasonable
- Maximizing UBIA limitation component
 - ▶ If assets are sold prior to end of year, UBIA will be \$0
 - ▶ Investigate whether Sec 199A aggregation is available with other entities

Sec. 199A Deduction – Year of Sale Tax Strategies

- Installment sales
 - ▶ Ordinary income on depreciation recapture (Sec. 1245 and Sec. 1250) must be recognized in the year of sale
- Asset sale by passthrough entity
 - ▶ Step #1 – gain on sale of assets reported on Sch. K-1, increasing the taxpayer's outside tax basis in their equity interest
 - ▶ Step #2 gain on liquidation of the investor's equity interest
 - A capital loss on liquidation can be common in an S corporation where they have been past ownership changes
 - Planning may be needed to trigger this loss in same tax year as sale of assets

Sec. 199A Deduction – Year of Sale Tax Strategies

- Charitable contributions
 - ▶ If the taxpayer is charitably inclined, the year of sale cash-flow spike could be used to fund larger than usual charitable amounts to a Donor Advised Fund to offset ordinary income
 - ▶ However, keep in mind the overall taxable income limitation for Sec. 199A
- Financial planning
 - ▶ Utilize a good financial planner to assist the taxpayer with putting their new cash flow and tax savings to work for their next phase of life
 - ▶ The Wipfli Financial team has some powerful modeling tools to help taxpayers visualize info and make decisions

Deductible Meal Expenses

- The Consolidated Appropriations Act (CAA)
 - ▶ Temporarily amends Sec. 274(n) to remove the 50% limit on deductions for business meals
 - ▶ Applies to expenses paid or incurred in calendar years 2021 and 2022
 - ▶ Expense must be for food or beverages provided **by** a restaurant
 - ▶ This new exception to the general 50% limitation isn't limited to meals eaten on the restaurant's premises – takeout and delivery meals provided by a restaurant also qualify
 - ▶ If food or beverages are provided at an entertainment activity, either they must be purchased separately from the entertainment , or their cost must be stated on a separate bill, invoice, or receipt
 - This is required because the entertainment, unlike the food and beverages, is nondeductible

Deductible Meal Expenses

- All other existing requirements to claim a meal deduction continue to apply:
 - ▶ Food and beverages cannot be lavish or extravagant under the circumstances
 - ▶ Owner or employee must be present when the food and beverages are served
 - ▶ The food or beverages must be provided to the taxpayer or a “business associate”
 - Current or prospective customer
 - Client
 - Supplier
 - Employee
 - Agent
 - Partner
 - Professional advisor