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THE HOFFMAN GROUP

Certified Public Accountants & Consultants

Claiming the Research & Development Tax Credit

The federal R&D tax credit can benefit organizations of all sizes and entity types, and opportunities are ripe in the construction industry

The federal R&D tax credit can benefit organizations of all sizes and entity types in almost any industry. Created in 1981 to incentivize companies to perform research and development in the United States, the credit offsets federal income tax liability, or in some instances can offset payroll tax liability for start-ups.

Many companies often overlook the benefits of the R&D tax credit under the misconception that their activities do not qualify for the credit. To be eligible, activities must only attempt to discover technical information to develop or improve a business component's functionality, performance, reliability, or quality by evaluating how to do so or the appropriate design of the business component. ***Taxpayers do not have to achieve a major scientific breakthrough or have revolutionary research to qualify.***

If your organization pays employees to develop new or improved products, processes, techniques, inventions, formulas, or software, then you may be eligible. If you are financing activities to try to develop or improve any of the following, you may be eligible for R&D tax credits:

- Energy efficiency
- LEED qualification
- Structural systems
- Construction equipment
- Mechanical systems
- Building materials and their combinations and uses
- Electrical and lighting systems
- Integration and constructability of building components
- Water systems
- Sanitary systems, including waste and wastewater treatment and disposal
- Plant performance or capacity
- Reclamation and remediation techniques
- Process design
- Structural boring techniques to allow construction in sensitive conditions
- Pilot plants
- Temporary structures used in the construction process
- Construction techniques
- Low-carbon technologies
- Flashing details
- Environmentally sustainable solutions

In addition, if you're at risk for the financing attempts to develop or improve construction and construction-related components like those above by any of the following, you also are likely to be performing qualified activities:

- Project architects
- Engineers
- Design services advisors
- Electrical designers
- Mechanical designers
- HVAC fabricators
- Lean and Kaizen specialists
- Material scientists

Your efforts do not have to succeed to qualify, and you don't have to be trying to revolutionize the industry to qualify. Attempts to develop incremental, evolutionary product and process improvements are eligible as well.

Contact us to learn more.

Second Round of PPP Loans: Here's What Changed

The Consolidated Appropriations Act provides over $300 billion in aid for small businesses and reopens the Paycheck Protection Program with important changes

December 27, President Trump signed the $900 billion COVID-19 relief bill into law, passed by Congress on December 21. The legislation, called The Consolidated Appropriations Act, provides over $300 billion in aid for small businesses and reopens the Paycheck Protection Program with some important changes.

Eligibility for Second-Time Borrowers

Borrowers who previously received a PPP loan may apply for a second loan if the meet the following criteria:

- Have fewer than 300 employees
- Experienced at least a 25% reduction in gross receipts during 2020 quarter compared to the same quarter in 2019
    - For businesses that were not open all of 2019, or opened before 2/15/2020, there are different tests for comparing gross receipts
- Have used or will use the full amount of their first PPP loan

Second-time borrowers must apply before March 21, 2021.

How Much Can Second-Time Borrowers Borrow?

PPP2 loans for second-time borrowers are capped at $2 million (previously $10 million) and calculated using 2.5x their average monthly payroll for calendar year 2019 or a 1-year period immediately prior to applying.

Seasonal businesses (those who operate 7 months or less or earn 2/3% or more of their receipts in 6 months of the year) may use the average monthly payroll of any 12-week period between 2/15/2019 and 2/15/2020 to calculate their loan amount. New entities formed after 2/15/2020 may use the monthly average of their payroll paid so far.

Entities assigned an NAICS code beginning with 72, such as restaurants and hotels, may apply for 3.5x their average monthly payroll. For these businesses, the 300-employee limit is determined by location rather than company-wide.

PPP Loan Eligibility for First-Time Borrowers

The maximum loan amount for first-time borrowers is $10 million, like in the first round, and businesses must have 500 or fewer employees to be eligible.

If a company returned all or part of its original loan, or did not take 100% of the original maximum, **and** has not yet applied for forgiveness, the company can apply for the maximum amount or the difference between its maximum and what it received, up to a total of $10 million.

Additional Eligible Nonpayroll Costs

To receive full loan forgiveness, borrowers must still spend at least 60% of their loan funds on payroll. Along with rent, mortgage, and utilities, forgivable nonpayroll costs have been expanded for first and second-time borrowers to include:

Covered Operations Expenditures:
A payment for any business software or cloud computing service

Covered Property Damage Costs:
A cost related to property damage and vandalism or looting due to public disturbances that occurred during 2020 that was not covered by insurance or other compensation

Covered Supplier Costs:
Expenditures made by a borrower to a supplier of goods for the supply of goods that both:

A: are essential to the operations of the borrower at the time at which the expenditure is made; and

B. is made pursuant to a contract, order, or purchase order

i: in effect at any time before the covered period with respect to the applicable covered loan; or

ii: with respect to perishable goods, in effect before or at any time during the covered period with respect to the applicable covered loan

Covered Worker Protection Expenditure:
An operating or a capital expenditure to facilitate the adaptation of the business activities of an entity to comply with health rules. This may include the purchase, maintenance or renovation of assets that create or expand a drive-through facility, a physical barrier such as a sneeze guard, or an indoor, outdoor, or combined air or air pressure ventilation or filtration system, among others.

Tax Treatment

Borrowers may deduct PPP expenses paid for with PPP funds, effective as of the date of enactment of the CARES Act, 3/27/2020.

In the case of a partnership or S Corporation, any amount excluded from income is treated as tax exempt income for purposes of Sections 705 and 1366 (basis provisions for partnerships and S Corporations, respectively). Any increase in the adjusted basis of a partner's interest in a partnership under Section 705 shall equal the partner's distributive share of deductions resulting from costs giving rise to forgiveness.

The new legislation also repeals the requirement that PPP borrowers deduct the amount of any Economic Injury Disaster Loan (EIDL) advance from their PPP forgiveness amount.

Important: Loan forgiveness is not tax-exempt income until it is forgiven, but the expenses are deductible the year they are spent. This could create basis issues because of timing.

Additional PPP Changes

- Borrowers can select the length of their covered period, which must be between 8 and 24 weeks from the date of their loan's disbursement
- There will be a simplified loan application for loans of up to $150,000
- You can now receive both an Employee Retention Tax Credit and a PPP Loan, however you cannot use the same wages for both
- Economic Injury Disaster Loans (EIDL) - If you didn't get full $10k first time, you can get rest now

Defining Gross Receipts

For a for-profit business, gross receipts generally are all revenue in whatever form received or accrued (in accordance with the entity's accounting method, i.e., accrual or cash) from whatever source, including from the sales of products or services, interest, dividends, rents, royalties, fees, or commissions, reduced by returns and allowances but excluding net capital gains and losses. These terms carry the definitions used and reported on IRS tax return forms.

Gross receipts do not include the following:

- Taxes collected for and remitted to a taxing authority if included in gross or total income, such as sales or other taxes collected from customers (this does not include taxes levied on the concern or its employees)
- Proceeds from transactions between a concern and its domestic or foreign affiliates
- Amounts collected for another by a travel agent, real estate agent, advertising agent, conference management service provider, freight forwarder or customs broker

All other items, such as subcontractor costs, reimbursements for purchases a contractor makes at a customer's request, investment income, and employee-based costs such as payroll taxes, may not be excluded from gross receipts.

Business Tax Changes in the New Stimulus Package

Here are some of the business tax changes contained in the new stimulus package

Deduction for Energy Efficient Commercial Buildings (Section 179D Deduction)

A deduction can be claimed for energy efficient improvements to heating, cooling, lighting, hot water systems, and ventilation of commercial property, including a $1.80 deduction per square foot for construction on qualified property. A partial deduction per square foot is allowed if certain subsystems meet energy standards but the entire building does not.

Extension of Credits for Paid Sick and Family Leave

The provision extends the refundable payroll tax credits for paid sick and family leave, enacted in the Families First Coronavirus Response Act, through the end of March 2021. It also modifies the tax credits so that they apply as if the corresponding employer mandates were extended through the end of March 2021. This provision is effective as if included in the Families First Coronavirus Response Act.

Business Meal Deduction

The 50% limit on business meal deductions is suspended for meals provided by restaurants in 2021 and 2022. Business meals in restaurants, including any carryout or delivery meals, will be 100% deductible for 2021 and 2022.

If food or beverages are provided at an entertainment activity (such as a sporting event or theater performance), either they must be purchased separately from the entertainment or their cost must be stated on a separate bill, invoice, or receipt. Entertainment, unlike the food and beverages, is nondeductible.

Repayment of Payroll Tax

Employers who are deferring their workers' payroll taxes under the former President's executive order now have until 12/31/2021 (originally 4/1/2021) to increase their employee's withholding to pay back the taxes owed. Penalties and interest on deferred unpaid tax liability will not begin to accrue until 1/1/2022.

Expansion and Modification of the Employee Retention Credit

The Employee Retention Credit (ERC) is extended to June 30, 2021 and modified for calendar quarter beginning after 12/31/2020 as follows:

- Expands the employee retention credit from a 50% refundable tax credit to 70%
- Increases the limit on employee wages from $10,000 per year to $10,000 per quarter (up to $7,000 per quarter per eligible employee)
- Reduces the required reduction amount in gross revenue in determining a substantial reduction from 50% to 20%
- Creates a safe harbor so that an employer can use prior-quarter gross receipts in determining eligibility
- The definition of a large employer is modified to mean more than 500 employees (currently the threshold is 100 employees), and new employees who were not with the business all or part of 2019 can now get the credit

30-Year Depreciation of Certain Residential Rental Property

30-year cost recovery life applies even for residential real property placed in service before January 1, 2018 by an electing real property trade or business.

Changes to the Work Opportunity Tax Credit

Employers may use an elective general business tax credit if they hire individuals who are members of one or more of ten targeted groups under the Work Opportunity Tax Credit (WOTC) program.

Prior to the TCDTR, the WOTC, which is based on qualified first-year wages paid to the hire, applied to hires before 1/1/2021. The TCDTR extended the Work Opportunity Credit through 2025.

Employer Payments of Student Loans

Section 127 provided that educational assistance provided under an employer's qualified educational assistance program, up to an annual maximum of $5,250, was excluded from the employee's income. The CARES Act added to the educational payments excluded from an employees gross income, "eligible student loan repayments," made after 3/27/2020 and before 1/1/2021. These payments are subject to the overall $5,250 per employee limit for all educational payments.

Eligible student loan repayments are payments by the employer, whether paid to the employee or a lender, of principal or interest on any qualified higher education loan for the education of the employee, but not of a spouse or dependent.

Forecasting for the New Year

Start off 2021 right: Prepare your company's prospective income statement, balance sheet and statement of cash flows

Planning for what lies ahead is an important part of running a healthy business. Forecasting your company's financial statements can help you manage inventory and other working capital accounts, offer competitive prices, identify impending cash flow shortages and keep your business on solid financial footing.

No forecast will be 100% accurate, especially during these uncertain times. However, answering the following questions can help make your predictions more relevant.

How far into the future do you plan to forecast?

Forecasting is generally more accurate in the short term — the longer the time period, the more likely it is that customer demand or market trends will change. While quantitative methods, which rely on historical data, are typically the most accurate forecasting methods, they don't work well for long-term predictions or when market conditions change. If you're planning to forecast over several years, try qualitative forecasting methods, which rely on expert opinions instead of company-specific data.

How steady is your demand?

Weather, sales promotions and other factors can cause sales to fluctuate. For example, if you operate an ice cream truck, chances are good your sales dip in the winter. If demand for your products varies, consider forecasting with a quantitative method, such as time-series decomposition, which examines historical data and allows you to adjust for market trends, seasonal trends and business cycles. You also may want to adopt forecasting software, which allows you to plug other variables into the equation, such as individual customers' short-term buying plans.

How much data do you have?

Quantitative forecasting techniques require varying amounts of historical information. For instance, you'll need about three years of data to use exponential smoothing, a simple yet fairly accurate method that compares historical averages with current demand. If you want to forecast for something you don't have data for, such as a new product, you'll need to either use qualitative forecasting or base your forecast on historical data for a similar product in your arsenal.

How do you fill your orders?

If your business uses "push" production methods (such as a factory that makes and stores large quantities of standard products) rather than "pull" methods (such as a retailer that takes custom orders), forecasting is particularly critical for establishing accurate inventory levels and improving cash flow. For peak accuracy, take the average of multiple forecasting methods. To optimize inventory levels, consider forecasting demand by individual products as well as at the local warehouse level, which will help you ensure speedy delivery.

How many types of products do you sell?

If you're forecasting demand for a wide variety of products, consider a relatively simple technique, such as exponential smoothing. If you offer only one or two key products, it's probably worth your time and effort to perform a more complex, time-consuming forecast for each one, such as a statistical regression.

New year, new forecast

The right forecasting techniques will help you predict your company's future with much more accuracy. We can help you establish the forecasting practices that make sense for your business.

IRS Allows Salt Cap Workaround for Pass-Through Entities

In November, the IRS confirmed that pass-through entity tax payments will be allowed as an entity-level deduction, which could result in significant tax savings for partners and shareholders

In November, 2020, the IRS issued Notice 2020-75 that addresses state and local income taxes imposed on pass-through entities (PTEs) such as partnerships and S corporations. The Tax Cuts and Jobs Act (which went into effect for tax years starting 1/1/18) limited the amount of state and local taxes an individual could deduct on Schedule A of their 1040. The limitation was set at $10,000 and has remained the same.

Since the introduction of that legislature, states have been trying to come up with a workaround so that the taxes would be captured at the entity level as opposed to passing them through to the partners/shareholders. Connecticut was the first state to introduce a pass-through entity tax, effective 1/1/18. They require the PTE to pay an entity-level tax of 6.99%.

Several states have started to follow Connecticut's lead and have introduced a pass-through entity tax. Some of the other states that, as of 2020, have enacted this type of tax include Louisiana, Maryland, New Jersey, Oklahoma, Rhode Island, and Wisconsin. Each state has separate rules and rates for this tax and different ways of electing to pay the tax.

The Notice states that the IRS will allow the workaround and that PTE tax payments will be allowed as an entity-level deduction. The regulations will apply to specified income tax payments made on or after November 9, 2020. It also states that the rules would pertain to specified income tax payments made in a tax year ending after 12/31/17 and made before 11/9/20, provided that the payment is for an entity-level tax.

Important: Keep in mind this only applies to states that have a PTE tax. If a state still requires an individual to pay the tax, that tax is not deductible at the entity level.

This Notice from the IRS could result in considerable tax savings for partners/shareholders who have been limited to the SALT cap of $10,000. The IRS still needs to issue the regulations related to this Notice, but individuals should consider electing to have their PTE pay the state income tax at the entity level in states that allow it.

Contact us for help

If you need assistance or have questions or concerns, The Hoffman Group is here to help. Please call 443-320-4101 or email info@hoffmancpas.com to speak with a Hoffman Group representative.

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