Businesses must navigate year-end tax planning with new tax laws potentially on the horizon

The end of the tax year is fast approaching for many businesses, but their ability to engage in traditional year-end planning may be hampered by the specter of looming tax legislation. The budget reconciliation bill, dubbed the Build Back Better Act (BBBA), is likely to include provisions affecting the taxation of businesses — although its passage is uncertain at this time.

While it appears that several of the more disadvantageous provisions targeting businesses won't make it into the final bill, others may. In addition, some temporary provisions are coming to an end, requiring businesses to take action before year end to capitalize on them. As Congress continues to negotiate the final bill, here are some areas where you could act now to reduce your business's 2021 tax bill.

Research and experimentation

Section 174 research and experimental (R&E) expenditures generally refer to research and development costs in the experimental or laboratory sense. They include costs related to activities intended to uncover information that would eliminate uncertainty about the development or improvement of a product.

Currently, businesses can deduct R&E expenditures in the year they're incurred or paid. Alternatively, they can capitalize and amortize the costs over at least five years. Software development costs also can be immediately expensed, amortized over five years from the date of completion or amortized over three years from the date the software is placed in service.

However, under the Tax Cuts and Jobs Act (TCJA), that tax treatment is scheduled to expire after 2021. Beginning next year, you can't deduct R&E costs in the year incurred. Instead, you must amortize such expenses incurred in the United States over five years and expenses incurred outside the country over 15 years. In addition, the TCJA requires that software development costs be treated as Sec. 174 expenses.

The BBBA may include a provision that delays the capitalization and amortization requirements to 2026, but it's far from a sure thing. You might consider accelerating research expenses into 2021 to maximize your deductions and reduce the amount you may need to begin to capitalize starting next year.

Income and expense timing

Accelerating expenses into the current tax year and deferring income until the next year is a tried-and-true tax reduction strategy for businesses that use cash-basis accounting. These businesses might, for example, delay billing until later in December than they usually do, stock up on supplies and expedite bonus payments.

But the strategy is advised only for businesses that expect to be in the same or a lower tax bracket the following year — and you may expect greater profits in 2022, as the pandemic hopefully winds down. If that's the case, your deductions could be worth more next year, so you'd want to delay expenses, while accelerating your collection of income. Moreover, under some proposed provisions in the BBBA, certain businesses may find themselves facing higher tax rates in 2022.

For example, the BBBA may expand the net investment income tax (NIIT) to include active business income from pass-through businesses. The owners of pass-through businesses — who report their business income on their individual income tax returns — also could be subject to a new 5% "surtax" on modified adjusted gross income (MAGI) that exceeds $10 million, with an additional 3% on income of more than $25 million.

Capital assets

The traditional approach of making capital purchases before year-end remains effective for reducing taxes in 2021, bearing in mind the timing issues discussed above. Businesses can deduct 100% of the cost of new and used (subject to certain conditions) qualified property in the year the property is placed in service.

You can take advantage of this bonus depreciation by purchasing computer systems, software, vehicles, machinery, equipment and office furniture, among other items. Bonus depreciation also is available for qualified improvement property (generally, interior improvements to nonresidential real property) placed in service this year. Special rules apply to property with a longer production period.

Of course, if you face higher tax rates going forward, depreciation deductions would be worth more in the future. The good news is that you can purchase qualifying property before year-end but wait until your tax filing deadline, including extensions, to determine the optimal approach.

You can also cut your taxes in 2021 with Sec. 179 expensing (deducting the entire cost). It's available for several types of improvements to nonresidential real property, including roofs, HVAC, fire protection systems, alarm systems and security systems.

The maximum deduction for 2021 is $1.05 million (the maximum deduction also is limited to the amount of income from business activity). The deduction begins phasing out on a dollar-for-dollar basis when qualifying property placed in service this year exceeds $2.62 million. Again, you needn't decide whether to take the immediate deduction until filing time.

Business meals

Not every tax-cutting tactic has to be dry and dull. One temporary tax provision gives you an incentive to enjoy a little fun.

For 2021 and 2022, businesses can generally deduct 100% (compared with the normal 50%) of qualifying business meals. In addition to meals incurred at and provided by restaurants, qualifying expenses include those for company events, such as holiday parties. As many employees and customers return to the workplace for the first time after extended pandemic-related absences, a company celebration could reap you both a tax break and a valuable chance to reconnect and re-engage.

Stay tuned

The TCJA was signed into law with little more than a week left in 2017. It's possible the BBBA similarly could come down to the wire, so be prepared to take quick action in the waning days of 2021. Turn to us for the latest information.