August 2020

Tax Credit Opportunities Available to Business Owners in 2020

There is a bounty of business tax credits ripe for the picking in 2020. By familiarizing ourselves with what's out there, we can end the year on a positive note and set ourselves up for a successful 2021.

Below we have summarized over a dozen tax credits that we anticipate will be helpful to business owners as they navigate the pandemic in 2020. But before we dive in, let's first review what credits are and how they affect our tax returns.

Difference Between a Deduction and a Credit

The terms "deductions" and "credits" are often used interchangeably, but they serve different purposes. Tax deductions reduce the tax base while tax credits reduce the tax itself. Both have the potential to lower the amount of income tax an individual or corporation owes, but they go about that task differently.

The tax calculation for most taxpayers looks more or less like this:

	Income
Less:	Deductions
	Taxable Income
Multiplied by:	Tax Rates
	Tentative Tax
Less:	Tax Credits
	Total Income Tax

A deduction reduces the tax base. By reducing taxable income, you will be reducing the amount of tax owed. However, the benefit will not be dollar-for-dollar. The amount of money you save is dependent on your marginal tax rate.

For example, if you are in the 22% tax bracket, a $10 deduction would save you only $2.20 in taxes.

A **credit** reduces taxes owed and does so on a dollar-for-dollar basis.

If your tax credit is $10, you will pay $10 fewer in taxes.

Refundable vs. Nonrefundable Tax Credits

Tax credits can be either refundable or nonrefundable, and understanding the difference is important when outlining your tax strategy. Both reduce taxes owed dollar-for-dollar, but nonrefundable tax credits can only reduce the amount of tax owed down to zero. Refundable credits, on the other hand, can reduce the tax liability beyond zero. If the refundable credit exceeds the tax owed, the difference is paid out as a refund.

Neither deductions nor credits are better than the other, but today we'd like to focus our attention on tax credits. The ones we feature below are just a handful of the ones available to small and medium-sized businesses.

Investment Tax Credits

New Markets Tax Credit

The New Markets Tax Credit was established in 2000. It incentivizes businesses to invest in distressed communities by providing a credit of up to 39% of the amount they infuse into a community development project. Investors can supply the developers with cash directly, but it is more common for businesses to invest in a third party (like a bank) first. The bank will accumulate multiple investments and then send those dollars to an organization that purchases or rehabilitates real estate, improves local business operations, or some other qualified use. Investors can take their credit in as little as seven years – 5% of investment costs the first three years, then 6% each year thereafter. These credits can be claimed on Form 8874.

Low-Income Housing Credit

The Low-Income Housing Credit incentivizes businesses to construct or refurbish housing earmarked for low-income households. Eligible households can be single family homes, apartment complexes, townhouses, or duplexes as long as those households are occupied by individuals whose income falls below certain levels. The credit is a percentage of project costs. This nonrefundable credit is reported on Form 8609.

Tax Credits for Non-Gas-Powered Vehicles

There are two noteworthy tax credits that reward businesses for purchasing vehicles that are powered by something other than gasoline or diesel. The Alternative Motor Vehicle Credit is available to businesses that purchase and place new vehicles in service that run using qualified fuel cell motors. The credit is dependent on the weight of the vehicle, but most purchases will generate a credit of at least $4,000. Businesses should report their Alternative Motor Vehicle Credit on Form 8910.

The Qualified Plug-In Electric Drive Motor Vehicle Credit rewards businesses for purchasing electric cars. The credit is currently being phased out, but businesses that purchased electric vehicles in 2019 or early 2020 may be eligible for partial credit. Taxpayers can claim this credit on Form 8936.

Rehabilitation, Energy, and Reforestation Investment Credits

Form 3468 reports a handful of investment tax credits including the Rehabilitation, Energy, and Reforestation Tax Credit. Businesses that renovate old buildings, plant trees and crops in areas that have been deforested, or use alternative energy like solar or wind power are eligible for this credit. The credit covers up to 10% of expenditures and is capped at $10,000 per year.

Workplace Tax Credits

Disabled Access Tax Credit

Eligible small business can use Form 8826 to claim the Disabled Access Tax Credit. This nonrefundable credit reimburses taxpayers at 50% of the costs (capped at $5,000 per year) of expanding accessibility in the workplace. Expenditures that qualify for the credit are providing interpreters, building ramps, purchasing documents in braille or audio format, or any other action that a business must take to comply with the guidelines outlined in the Americans with Disabilities Act (ADA).

Empowerment Zone Employment Tax Credit

Businesses that operate in an economically distressed “empowerment zone” may be eligible for a credit if they employ workers who live and work within that distressed area. The credit is good for 20% on the first $15,000 of wages paid to part-time or full-time eligible employees, with no cap for number of employees. Businesses can claim this credit by filing Form 8844.

Work Opportunity Tax Credit

The Work Opportunity Tax Credit (WOTC) rewards employers for hiring individuals from certain marginalized groups who have historically faced barriers to employment, including veterans, ex-felons, and Supplemental Nutrition Assistance Program (SNAP) recipients. The WOTC is nonrefundable and will reward businesses with between 25% and 50% of employees’ wages, providing a higher credit percentage the longer a worker remains employed with the company. Most employers can take this credit on Form 5884 to offset income taxes, but some tax-exempt organizations can take their credit against payroll taxes.

Alternative Fuel Tax Credits

Some fuel tax credits were set to expire at the end of 2019, but the Further Consolidated Appropriations Act of 2020 extended those benefits. Three that are available this year are:

1. Biodiesel Mixture Tax Credit
2. Alternative Fuel Tax Credit
3. Alternative Fuel Mixture Tax Credit

Each of these credits reimburses taxpayers for alternative fuels that they used or sold during the year, at a rate between $.50 to $1.00 per gallon. These tax credits must first be used to offset excise tax liabilities, but some can be converted into refundable income tax credits.

Employee Retention Tax Credit

The Employee Retention Tax Credit was one of the provisions written into the Coronavirus Aid, Relief, and Economic Security (CARES) Act that encourages businesses to keep workers on their payroll. The credit is for up to 50% of wages that are paid to keep workers employed when the organization experiences coronavirus-related disruptions. An eligible disruption is when operations have been fully or partially suspended due to a Federal, state, or local mandate, or when there has been a 50% or more decline in gross receipts measured against a comparable quarter in 2019.

This credit is refundable, but it is not an income tax credit; it is a credit against payroll taxes. By taking the credit against payroll taxes, businesses can reap the benefits almost immediately. The benefit is accumulated on up to $10,000 of wages per employee (including the costs of medical benefits), which means that the maximum benefit businesses can get from this credit is $5,000 per employee.

Businesses that have fewer than 100 employees can utilize the Employee Retention Tax Credit for all payroll through the end of the year, regardless if employees’ job duties have been impacted. Businesses with more than 100 employees can only take the credit for employees’ wages if they are unable to fulfill their job responsibilities as a result of a change in operations.

Research Tax Credit

The Credit for Increasing Research Activities, commonly called the Research and Development (R&D) Tax Credit, has been around for decades and was created to reward companies for investing in R&D. The credit is based on a company's incremental increase in R&D spending, including wages paid to employees for conducting R&D activities and amounts paid to contractors for performing research or testing.

Businesses do not need necessarily need to create new products or discover something groundbreaking to be eligible for the R&D Credit. Simply working to improve business processes or altering existing products can be enough. Qualified research activities (1) are technological in nature, (2) are performed to improve the functionality, performance, reliability, or quality of a business component, (3) eliminate technical uncertainty in the development or improvement of a product or technology, and (4) include a process of experimentation like testing, modeling, or simulating.

The credit is 20% of research expenses that exceed an amount from a benchmark year, or 14% if you use the simplified alternative credit. 100% of in-house expenses can be taken into account, but only 65% of contracted expenses can be considered. Taxpayers can report their R&D Tax Credit on Form 6765.

Nothing has changed with the R&D Tax Credit for the 2020 tax year, but businesses should pay close attention to their credits if they elected to carry back net operating losses (NOLs). The CARES Act included a provision that allows businesses to carry NOLs back to 2018 and 2019. In doing so, R&D Credits that were applied against taxable income in those years may get pushed forward and can be applied to current year or future tax liabilities.

Benefits Tax Credits

Small Employer Pension Plan Startup Costs Tax Credit

Small businesses can use Form 8881 to claim a credit for 50% of the costs they incur (up to $500) to establish a qualified pension plan. *The credit is only available when:*

1. The organization has 100 or fewer employees
2. The organization did not offer a credit-eligible plan in the last three years to the same group of employees
3. The plan is made unavailable to low-paid employees

Eligible costs are those to set up, administer, and educate employees about the plan. The credit can be carried back to tax year 2002 or later, or it can be carried forward and applied against future tax liabilities.

Credit for Small Employer Health Insurance Premiums

Small businesses that subsidize their employees' health insurance premiums may be able to receive some of those payments back as a credit. The nonrefundable income tax credit, reported on Form 8941, is 35% of insurance premiums paid by tax-exempt employers and 50% for all others. There are quite a few hoops to jump through, though.

- The insurance coverage must be obtained through the Affordable Care Act marketplace
- Employers must pay at least 50% of their employees' premiums
- The organization must have 24 or fewer full-time employees
- Full-time employees must make an average salary of less than $55,000 (adjusted for inflation)

Credit for Paid Sick Leave and Credit for Paid Family Leave

Two tax credits were created by the Families First Coronavirus Response Act (FFCRA) to reward businesses for providing paid leave to their employees.

1. The Paid Sick Leave Tax Credit refunds employers for providing up to 10 days of sick leave to employees affected by the coronavirus between April 1, 2020 and the end of the year. Sick leave can be awarded to employees who are – for example – self-quarantining, unable to work due to illness, or taking care of someone who is sick with COVID-19 symptoms. 100% of wages are eligible for the credit, up to a maximum of $5,110 per employee.

2. The Paid Family Leave Tax Credit refunds employers for providing an additional 10 weeks of paid family and medical leave (FMLA) to employees that need to care for children because of coronavirus-related closures or health concerns. Only 2/3 of the employee's regular pay is eligible for this credit, up to $200 per day or $10,000 in total.

Both credits are taken against payroll taxes. They reduce the amount employers are required to deposit, allowing them to retain those funds and utilize them immediately. Credits that exceed payroll tax liabilities can be accelerated (and refunded) using Form 7200.

Credit for Employer-Provided Childcare Facilities

The Credit for Employer-Provided Childcare Facilities has been around for years, but it was brought back into the limelight when the pandemic hit. There are two facets to the credit: (1) the 25% credit for facility expenditures and (2) the 10% credit for resource and referral expenditures.

Facility Expenditures

Businesses that establish childcare facilities in 2020 can receive a credit for 25% of costs to acquire, construct, rehabilitate, or expand a facility, and for operational costs of running the facility, like childcare training courses and certifications for workers. But the great thing about this credit is that it applies even when employers pay for a third-party service to provide childcare services. To receive the credit, all of the following *must* be true:

1. The facility cannot discriminate in favor of highly compensated employees
2. The facility must have open enrollment during the tax year for employees
3. The facility must be licensed and follow all local and state regulations
4. The principal use of the facility must be used to provide childcare services

If the facility ceases operation within 10 years, some of the credit will need to be recaptured.

Resource and Referral Expenditures

The 10% credit for resources and referrals can be applied when the business provides resources or referral services to its employees for help finding a suitable childcare facility.

Both the Facility and Resource/Referral expenditures credits can be reported on Form 8882.

BONUS: Deferral on Employment Taxes

Though not a tax credit, the employment tax deferral program is something that business leaders should consider when planning for the year ahead.

When the CARES Act was passed this March, Congress permitted employers to defer paying their share of Social Security tax deposits without incurring penalties or interest. Businesses can retain the employer's portion of Social Security tax (6.2%) for wages paid through the end of this year. Repayment is required shortly thereafter, with 50% of the amount due on December 31, 2021 and the remainder due on December 31, 2022.

On August 8, 2020, President Trump signed an Executive Order that allows businesses to retain tax deposits for the employee's portion of Social Security tax (6.2%) on wages paid through the end of the year. But this is where the two deferral programs diverge. This Executive Order was intended to benefit employees. Businesses are expected to pass along those deferred taxes to the employee rather than retain it within the business. Unfortunately, it's unlikely many businesses will do this. Collecting back taxes from workers – especially workers no longer employed by the company – will prove difficult, and businesses may not want to be on the hook for back taxes that are uncollectible. We anticipate more information to be released about this deferral program in due time.

The list we've provided is not exhaustive; there are many other credits you can consider using in 2020 and 2021, including some that the IRS list here. If you have questions about the credits we outlined or any other credits you think will help your business withstand pandemic-related operational disruptions, please contact your M&J advisors today.