YEAR-END TAX PLANNING

FOR 2020

BY GLENN HANNER, CPA, CITP, CVA

I think it is safe to say that 2020 will go down in the books as an extraordinary year. Depending on what area of the country you are located, we went from a normal beginning to complete turmoil in a matter of about a few weeks. Thankfully for the veterinary profession, the road to recovery has been steady.

According to the VetSuccess industry tracker, average revenue dropped in April and began recovering in May. Through the end of August, nationwide average revenue is up 6% over the same period for 2019.

Regardless of the craziness 2020 has brought, there are several tax-related issues to think about as we turn our attention toward year-end.

In most year-end planning discussions, the conversation will explore the practice's equipment needs. While buying equipment just to generate income tax deductions is never advisable, there are many circumstances where the new equipment can also generate additional revenue, improve efficiency and save on repair costs, as well as provide needed tax relief through depreciation deductions.

The tax code determines the depreciable life for asset purchases, and most medical equipment used in veterinary hospitals is depreciated over five years. In addition to the normal depreciation, the tax code provides for additional expensing options using bonus depreciation and Section 179 expensing. Remember, depreciation choices are elections regarding the timing of the deduction, not the amount of the deduction.

While bonus depreciation is available for qualified assets with a useful life of 15 years or less and allows for 100% depreciation for new and used equipment, Section 179 allows for expensing a variable amount up to 100% of the purchase price. One important distinction is that Section 179 requires profit in order to take the deduction, while bonus depreciation can be taken even if the practice has a loss for the year.

You might think there is no need for Section 179 with bonus depreciation being so generous, but sometimes we only want a portion of the deduction in the current year. Year-end planning needs to consider future tax brackets so we don't waste an important deduction in a lower tax bracket when we know we will be in a higher bracket in a later year.

Let's walk through an example. Let's say you have determined a new digital radiography system would not only improve your efficiency, but also generate additional revenue. You purchase the new system for $50,000, expecting to write off the full amount. In looking at your year-end profit with your accountant, you realize that you don't need the full $50,000 this year and would like to preserve some of those deductions for future years. Bonus depreciation is an all-or-nothing choice, so one option would be to elect out of bonus depreciation and take Section 179 for a portion of the purchase. You would then spread the balance over five years. This choice preserves a portion of those deductions for future years when you expect to be in a higher tax bracket.

Tax brackets are not the only consideration at the federal level. Beginning in 2018, the Qualified Business Income (QBI) deduction became available for pass-through entities. The QBI deduction allows for a 20% deduction on qualified business income for business owners below a taxable income threshold. While the QBI deduction is a much more involved discussion than space allows, bonus and Section 179 depreciation may be one option to bring the taxable income below the QBI threshold, generating additional deductions not previously available due to the owner's income phaseout.

Another consideration when thinking about depreciation is the amount allowed by your state. Many states have elected to not follow the federal lead when it comes to bonus depreciation and Section 179. If your state does not follow the federal depreciation rules, you might choose a different strategy when it comes to state depreciation. Balancing the federal and state deductions is normally done at tax preparation by running different scenarios to determine the most tax-efficient strategy.

A new wrinkle this year has to do with the Paycheck Protection Program loan forgiveness. In response to the economic slowdown in early 2020, Congress passed the CARES Act, which established the Paycheck Protection Program ("PPP") that provided loans for qualifying small businesses. Under the CARES Act, proceeds received by a borrower from a PPP loan may be forgiven if the borrower uses the proceeds to pay specified expenses including payroll costs, interest on qualified mortgage indebtedness, rent under a qualified lease contract, and qualified utilities.

The law specifically states that the loan forgiveness will not be taxable. Soon after the details were released, the IRS issued Notice 20-32 saying that while the forgiveness is not taxable, the tax code and regulations provide that no deduction is allowed for any expense that is allocable to income that is exempt from tax. Denying the deduction has the same effect as taxing the forgiveness. Several bills have been introduced to correct the issue, but as of the first of September, nothing has been passed. Without congressional intervention, tax planning needs to include not being able to deduct those specific expenses covered by the PPP loan.

There are a few planning tips that apply even in years without a pandemic. For those of you on the cash method of accounting, you need to consider paying down your accounts payable (not loan payments or credit card payments) as much as possible before December 31. If you are not sure whether you are on the cash method or not, ask your accountant.

Paying accounts payable bills by charging them on a credit card has the same effect as paying them with cash, so don't overlook the opportunity to move the deduction into this year by paying with a credit card.

When thinking of paying down accounts payable, focus on operating expenses and cost of goods sold. For example, paying your property tax bill would decrease your net income for the year. Paying a credit card balance due will not affect your income because you have already expensed the amounts charged to the card.

For those on the accrual method of accounting, make sure you have recorded all your vendor bills prior to the end of the year. Also, carefully consider your accounts receivable for write-offs of bad debt.

Tax planning is not a one-size-fits-all proposition. There is no substitute for a plan that considers your specific practice and personal circumstances. With 2020 being such an unusual year, it would be a great idea to start having the planning conversation with your accountant today. ■

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He enjoys helping veterinarians create long-term value from their practice and achieve their professional goals. He is on the board of directors for VetPartners and is the former co-chair of the VetPartners Valuation Council. Glenn speaks to veterinarians across the country on practice management and valuation issues. He is co-author of the American Animal Hospital Association book Selling Your Practice.