Tax & Business Alert

SEPTEMBER 2021

THE CURRENT STATE OF ESTATE PLANNING

Because of the current estate tax exemption amount ($11.7 million in 2021), many estates no longer need to be concerned with federal estate tax. Years ago, a much smaller exemption amount put more pressure on estate plans to avoid it. Now that many estates won't be subject to estate tax, you can devote more energy to other aspects of estate planning.

USE THE EXCLUSION

Among the benefits of using the gift tax annual exclusion to make transfers during your life is to save estate tax. This is because both the transferred assets and any post-transfer appreciation generated by those assets are removed from a donor's estate.

As mentioned, estate tax savings may not be an issue because of the large estate exemption amount. Further, making an annual exclusion transfer of appreciated property carries a potential income tax cost because the recipient receives the donor's basis upon transfer. Thus, the recipient could face income tax, in the form of capital gains tax, on the sale of the gifted property in the future. If there's no concern that an estate will be subject to estate tax, even if the gifted property grows in value, then the decision to make a gift should be based on other factors.

For example, gifts may be made to help a relative buy a home or start a business. But a donor shouldn't gift appreciated property because of the capital gain that could be realized on a future sale by the recipient. If the appreciated property is held until the donor's death, under current law, the heir will get a step-up in basis that will wipe out the capital gains tax on any pre-death appreciation in the property's value. (Note: The Biden administration has proposed ending this tax break, with some exceptions.)

LOOK TO SPOUSAL ACCOUNTS

In the past, spouses often undertook complicated strategies to equalize their estates so that each could take advantage of the estate tax exemption amount. Generally, a two-trust plan was established to minimize estate tax. "Portability," or the ability to apply the decedent's unused exclusion amount to the surviving spouse's transfers during life and at death, became effective for estates of decedents dying after 2010.

DON'T RELY ON AN OUTDATED STRATEGY

Some estate exclusion or valuation discount strategies to avoid inclusion of property in an estate may no longer be worth pursuing. It may be better to have the property included in the estate or not qualify for valuation discounts so that the property receives a step-up in basis. For example, the special use valuation — the valuation of qualified real property used for farming or in a business on the basis of the property's actual use, rather than on its highest and best use — may not save enough, or any, estate tax to justify giving up the step-up in basis that would otherwise occur for the property.

If the election is made, portability allows the surviving spouse to apply the unused portion of a decedent's applicable exclusion amount (the deceased spousal unused exclusion amount) as calculated in the year of the decedent's death. The portability election gives married couples more flexibility in deciding how to use their exclusion amounts.

IDENTIFY STRATEGIES

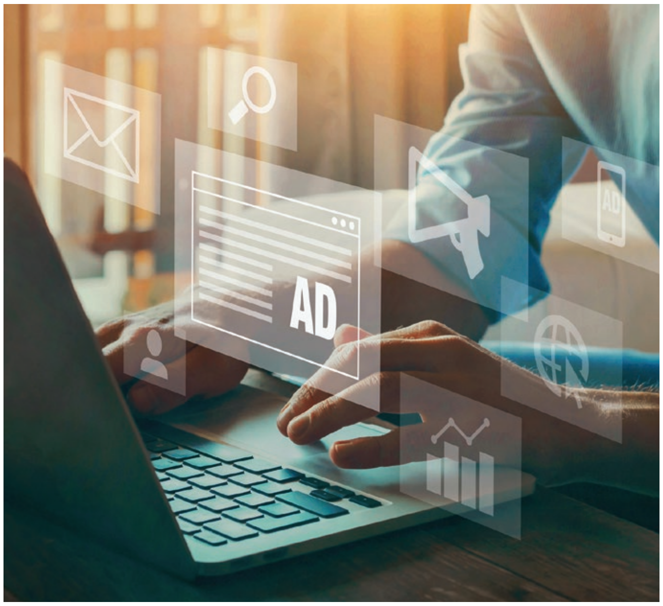
Although the federal estate tax is currently less onerous, estate planning is still a complex yet critical task. Contact us to discuss these strategies and how they might relate to your estate plan. ■

WHICH BUSINESS WEBSITE COSTS ARE DEDUCTIBLE?

Every business needs a website, but it's not always easy to determine which costs of running one are deductible. Fortunately, established rules that generally apply to the deductibility of more long-standing business costs provide business owners with a basic idea of how to anticipate and handle the tax impact of a website. And the IRS has issued guidance that applies to software costs.

HARDWARE CONSIDERATIONS

Hardware costs generally fall under the standard rules for depreciable equipment. Specifically, once website-related assets are up and running, you can deduct 100% of the cost in the first year they're placed in service (before 2023). This favorable treatment is allowed under the 100% first-year bonus depreciation break.



In later years, you can probably deduct 100% of these costs in the year the assets are placed in service under the Section 179 first-year depreciation deduction privilege. However, Sec. 179 deductions are subject to several limitations.

For the 2021 tax year, the maximum Sec. 179 deduction is $1.05 million, subject to a phaseout rule. Under the rule, the deduction is phased out if more than a specified amount of qualified property is placed in service during the year. The threshold amount for 2021 is $2.62 million.

There's also a taxable income limit. Under it, your Sec. 179 deduction can't exceed your business taxable income. In other words, Sec. 179 deductions can't create or increase an overall tax loss. However, any Sec. 179 deduction amount that you can't immediately deduct is carried forward and can be deducted in later years (to the extent permitted by the applicable limits).

SOFTWARE ISSUES

Similar rules apply to off-the-shelf software that you buy for your business. However, software license fees are treated differently from purchased software costs for tax purposes. Payments for leased or licensed software used for your website are currently deductible as ordinary and necessary business expenses.

An alternative position is that your software development costs represent currently deductible research and development costs under the tax code. To qualify for this treatment, the costs must be paid or incurred by December 31, 2022. A more conservative approach would be to capitalize the costs of internally developed software. Then you would depreciate them over 36 months.

If your website is primarily for advertising, you can also currently deduct internal website software development costs as ordinary and necessary business expenses.

Are you paying a third party for software to run your website? This is commonly referred to as "software as a service." In general, payments to third parties are currently deductible as ordinary and necessary business expenses.

STILL IMPORTANT

So much of business today seems to happen in virtual places other than your website — such as social media, apps and teleconferencing calls. Nonetheless, a central website where you can provide a solid overview of your company is still important. We can help you determine the appropriate tax treatment of website costs. ■

ENERGIZE TAX SAVINGS WITH AN EV CREDIT

Electric vehicles (EVs) are increasing in popularity all the time — and more of them are qualifying for a federal tax credit. In fact, the IRS added several more eligible models over the summer.

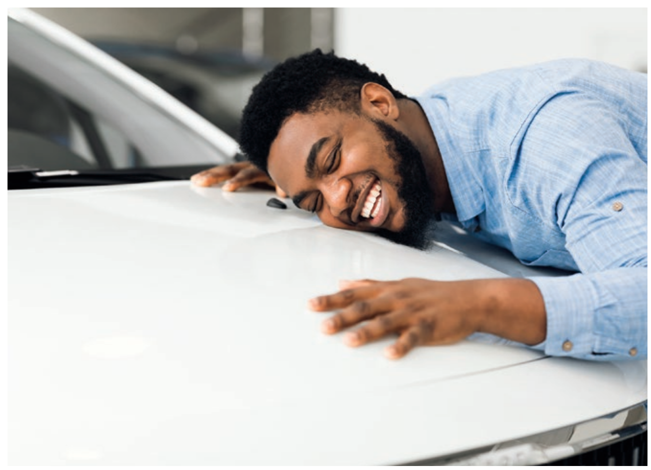
The tax code provides a credit to buyers of qualifying plug-in electric drive motor vehicles, including passenger vehicles and light trucks. The credit is equal to $2,500 plus an additional amount, based on battery capacity, that can't exceed $5,000. Therefore, the maximum credit allowed for a qualifying EV is $7,500.

EV DEFINITION

For purposes of the tax credit, a qualifying vehicle is defined as one with four wheels that's propelled to a significant extent by an electric motor, which draws electricity from a battery. The battery must have a capacity of not less than four kilowatt hours and be capable of being recharged from an external source of electricity.

The credit may not be available because of a per-manufacturer cumulative sales limitation. Specifically, it phases out over six quarters beginning when a manufacturer has sold at least 200,000 qualifying vehicles for use in the United States (determined on a cumulative basis for sales after December 31, 2009). For example, Tesla and General Motors vehicles are no longer eligible for the tax credit.

The IRS provides a list of qualifying vehicles on its website and, as mentioned, recently added more eligible models. You can access the list here: https://bit.ly/2Yrhg5Z.



ADDITIONAL POINTS

There are some additional points about the plug-in electric vehicle tax credit to keep in mind. It's allowed only in the year you place the vehicle in service, and the vehicle must be new. Also, an eligible vehicle must be used predominantly in the United States and have a gross weight of less than 14,000 pounds.

There's a separate 10% federal income tax credit for the purchase of qualifying electric two-wheeled vehicles manufactured primarily for use on public thoroughfares and capable of at least 45 miles per hour (in other words, electric-powered motorcycles). It can be worth up to $2,500. This electric motorcycle credit was recently extended to cover qualifying 2021 purchases.

BASIC RULES

These are only the basic rules. There may be additional incentives provided by your state. Contact us if you'd like to receive more information about the federal plug-in electric vehicle tax break. ■