Supplement to J.K. Lasser's Small Business Taxes 2021

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The pandemic triggered numerous changes in tax law as reflected in the book. But tax law is not static and new legislation, IRS pronouncements, and court decisions continue to tweak tax rules. They impact reporting on 2020 returns as well as tax planning for 2021 and beyond.

The Consolidated Appropriations Act, 2021 (CAA), which runs 5,593 pages and was signed into law on December 27, 2020, made a number of changes impacting small businesses and their owners. Some are reflected on 2020 returns; others do not take effect until 2021 and, thus, affect tax planning and estimated taxes for 2021.

The changes presented in this Supplement occurred after October 1, 2020, when this book was published. The changes are listed according to the chapters in which the subject matters appear.

Introduction

Forms and schedules. When this edition was published, final versions of forms were not yet available. Find final versions of forms and schedules here.

Schedule K-1 for partners. Partners' capital accounts must be reported on a tax basis method (not on methods such as GAAP) got returns filed for the 2020 tax year. Instructions to Form 1065 reflect this new requirement. However, the IRS said it would not impose accuracy-related penalties on partnerships for incorrect information this year.

Schedule K-1 for S corporation shareholders. The IRS has not created a new form, schedule, or worksheet for computing a shareholder's basis in stock and debt.

Chapter 1—Business Organization

Entity classification election. Form 8832 used by a corporation to elect S status or by other entities to change their tax classification can be filed using a digital signature even though the form cannot be filed electronically. This rule had applied through December 31, 2020, but the IRS said it was monitoring the situation and may extend this signature option.

Chapter 2—Tax Year and Accounting Method

Restrictions on the use of the cash method—small business exception. Final regulations clarify some rules for the gross receipts test. For sole proprietors, the term "gross receipts" means amounts derived from all a taxpayer's trades or businesses. There's aggregation of gross receipts for all persons treated as a single employer.

The regulations require a taxpayer that meets the gross receipts test in the current year to obtain IRS consent before changing to the cash method if the taxpayer had previously changed from the cash method during any of the preceding 5 years ending with the current tax year.

Uniform capitalization rules. For purposes of applying the gross receipts test in determining whether the UNICAP rules apply, an individual with 2 or more trades or businesses reported on Schedule C or E of Form 1040 or 1040-SR must aggregate gross receipts. Also, the gross receipts of a C corporation partner are included in the gross receipts of a partnership if the aggregation rules apply to the C corporation partner and the partnership.

Change in accounting method. Form 3115 used by a business to change its method of accounting can be filed using a digital signature even though the form cannot be filed electronically. This rule had applied through December 31, 2020, but the IRS said it was monitoring the situation and may extend this signature option.

Chapter 4—Income or Loss from Business Operations

PPP loans, EIDLs, and other government financing. CAA made a number of changes in the financing options available to small businesses, including self-employed individuals and gig workers.

PPP loan changes. The Paycheck Protection Program has been expanded by CAA in several ways:

- The program reopened in January 2021, but is set to close again on March 31, 2021.
- The definition of "covered expenses" have been expanded to include covered operational expenses, such as software, cloud computing, and other human resource and accounting needs, covered property damage costs related to riots in 2020 not covered by insurance, covered supplier costs for expenditures pursuant to a contract, purchase order, or order for goods in effect prior to taking out the loan that are essential to the recipient's operations at the time at which the expenditure was made, and covered worker protection expenditures like PPE.
- The covered period can end at the borrower's choice of between 8 and 24 weeks after the origination of the loan.
- There is a simplified loan forgiveness application for amounts of $150,000 or less.
- "Second draw loans" can be obtained by smaller and harder-hit businesses. The maximum loan is $2 million and the maximum number of employees is 300. The business needs to demonstrate a specified reduction in gross receipts and that original PPP funds have or will be used in full.

The IRS rule barring deductibility of expenses covered by forgiveness of PPP loans has been overturned, so that expenses—payroll, rent, utilities—are deductible under normal tax rules even if the loan is forgiven.

EIDL loan changes. The SBA's Economic Injury Disaster Loans program has been extended. Initially, there was a $10,000 advance payment in the nature of a grant. CAA makes it clear that the grant is tax free. What's more, those who obtained PPP loans as well don't have to repay this amount.

Direct payments to certain businesses. These are direct payments by the SBA to live entertainment venues, independent movie theaters, talent representatives, and museums that have been forced to close due to government-mandated shutdowns ("shuttered venue operators"). These grants can be used for payroll costs, rents, utilities, and PPE. They're tax free, while expenses are tax deductible.

Income from farming. The IRS has extended the livestock replacement period for certain drought-affected areas. Counties for 2020 can be found in Notice 2020-74.

S corporation basis. The AICPA suggestion to the IRS to create a tax form for tracking a shareholder's basis in stock and debt has not yet been acted upon. However, if a shareholder is claiming a loss on the return, Schedule E (where the loss is reported) must include an attachment showing the computation of the shareholder's adjusted basis of stock and any debts the corporation owes to the shareholder.

Noncorporate excess business losses. This limit on owners deducting their share of business losses on their personal returns was suspended for 2018, 2019, and 2020 (it is not taken into account on the 2020 return). The limit applies again in 2021.

In applying the limitation in 2021, losses are limited to the aggregate deductions for the year over aggregate gross income or gain from all your businesses, plus $250,000 or $500,000 on a joint return (as adjusted for inflation). The inflation adjustment means that the added dollar amount in 2021 is $262,000 ($524,000 on a joint return).

Net operating losses (NOLs). Farming businesses have been given flexibility with respect to net operating losses that arose in 2018 and 2019. The Tax Cuts and Jobs Act had given these businesses a 2-year carryback. CCA permits them to retain the 2-year carryback even though the CARES Act introduced a 5-year carryback for NOLs arising in 2018, 2019, and 2020. However, farming businesses may now opt to waive the 2-year carryback, or if they previously waived it, revoke the waiver. This permits farming businesses to use the 5-year carryback or simply carry NOLs forward indefinitely.

Starting in 2021, the 80% of taxable income limit applies for all businesses. For this purpose, taxable income is increased by the qualified business income (QBI) deduction, the deduction for foreign-derived intangible income (FDII), and the global intangible low-taxed income (GILTI). Taxable income is reduced by NOL carryovers from pre-2018 years.

Income earned abroad. The earned income exclusion for 2021 is capped at $108,700 (up from $107,600 in 2020).

The time requirement for the foreign earned income exclusion is waived for certain countries. Due to the global health emergency caused by COVID-19, the minimum time requirements necessary to meet the bona fide residence test or physical presence test for the foreign earned income exclusion have been waived if leaving the foreign country was required. This applies to leaving:

- The People's Republic of China (excluding Hong Kong and Macau) on or after December 1, 2019, but on or before July 15, 2020; or
- Another foreign country on or after February 1, 2020, but on or before July 15, 2020 (unless the IRS provides additional relief).

Chapter 5—Capital Gains and Losses

Taxable income breakpoints for capital gain rates in 2021. Owners of pass-through entities who are individuals pay tax on their share of capital gains. The following table (an update to Table 5.1 in the book) shows the break points for capital gain rates for 2021; this Table does not apply to 2020 returns.

Rate	**Married filing jointly (and surviving spouse)**	**Head of household**	**Single**	**Married filing separately**
0%	Up to $80,800	Up to $54,100	Up to $40,400	Up to $40,400
15%	$80,801 - $501,600	$54,101 - $473,750	$40,401 - $445,850	$40,401 - $250,800
20%	Over $501,600	Over $473,750	Over $455,850	Over $250,800

Like-kind exchanges. Final regulations clarify the definition of real property for purposes of like-kind exchanges, changing in some cases the definition in proposed regulations explained in the book. Under final regulations, the incidental personal property rule is retained, but state and local law definitions can now be controlling for purposes of determining "real property" for like-kind exchanges.

Chapter 7—Employee Compensation

Worker classification. Litigation challenging California's ABC test for determining whether workers are employees or independent contractors is ongoing. The California appeals court ruled in a case involving truckers that the state's test is not preempted by federal law. But a challenge in federal court is still underway.

The U.S. Department of Labor (DOL) issued a final rule on worker classification for purposes of the Fair Labor Standards Act, which governs minimum wage and overtime rules. The DOL's definition of independent contractor does not displace the IRS standards for determining worker classification for federal income and employment tax purposes (IRS rules for worker classification are explained in Chapter 7).

Deduction for compensation and PPP loans. The IRS had ruled that if forgiveness was obtained or reasonably expected for loans obtained a loan under the Paycheck Protection Program, then compensation covered by the loan would not be deductible in 2020. CAA repealed this bar to deductibility. This means obtaining loan forgiveness does not block a deduction for compensation to the extent otherwise allowed.

Adoption assistance. For planning purposes, the dollar limit on the exclusion for employer assistance for adoption costs in $14,440 for 2021 (up from $14,300 in 2020).

Education assistance. The ability of employers to pay student loan debt under an educational assistance plan up to the annual limit ($5,250), which had applied for 2020, has been extended for 5 years (through 2025). Employees are not taxed on this employee fringe benefit, while companies can deduct the cost.

Flexible spending accounts (FSAs) for medical expenses and dependent care expenses. For planning purposes, the maximum elective deferral to medical FSAs in 2021 is $2,750, which is unchanged from 2020.

CAA expanded planning opportunities for FSAs in 2021.

- Employees may be allowed to make mid-year election changes in 2021 (as was permitted in 2020). This means opting to participate, opting out of participation, or changing the salary reduction contribution. A change only applies going forward.
- Employees can carry over unused contributions to the following year if the plan allows it. This means that any of the used contribution in 2020 (up to the annual limit of $2,750) can be carried over to 2021, and any unused contribution in 2021 (up to the annual limit of $2,750) can be carried over to 2022.
- The grace period for using up contributions, which normally runs only to March 15, has been extended for the entire year. This applies for 2020 and 2021. Thus, unused contributions for 2020 and be used at any time in 2021.
- The age for a covered dependent in a dependent care FSA is increased from under age 13 to under age 14 for 2021.
- Employees who cease participation during the year because they've left the job (e.g., they've been laid off) can be reimbursed for unused amounts. This applies for 2020 and 2021.

  Reminder: A medical FSA can offer a carryover option or a grace period, but not both. An FSA is not required to offer either option.

Employee use of company car. For planning purposes, in valuing employee use of a company car in 2021, the IRS standard mileage rate is 56¢ per mile, down from 57.5¢ per mile in 2020.

The fixed and variable rate allowance (FAVR) in 2021 is limited to vehicles with a fair market value not exceeding $51,100 for cars, trucks, and vans. The rate in 2020 was $50,400.

Car and truck values taken into account by employers using the cents-per-mile valuation rule or the fleet valuation rule for valuing personal use of a company vehicle in 2021 is $51,100.

Qualified transportation fringe benefits. Employers cannot deduct these fringe benefits, but if they choose to provide the benefits or arrange for employees to pay for these costs on a pre-tax basis, employees can exclude up to $270 for free parking, transit passes, and van pooling for 2021 (unchanged from 2020). Since employers cannot deduct these fringe benefits, they are barred from deducting rent payments related to free parking (see information below for Chapter 12). Final regulations adopted in December 2020 generally follow proposed regulations reflected in Chapter 7.

Companies may allow employees to pay for transportation fringe benefits, such as monthly transit passes, through salary reductions. Due to COVID-19, many employees worked remotely, while some employees opted to drive to work rather than take public transportation. Informally, the IRS has said that unused compensation reduction amounts can be carried over to the subsequent period and used for future commuting expenses.

What's more, the unused amounts can be applied to a different type of commuter expenses, such as qualified parking instead of transit passes, as long as the employer plan covers all such options. Of course, all this depends on the terms of the employer's transportation fringe benefit plan. Small businesses with transportation fringe benefit plans may want to redesign them to permit this type of flexibility going forward.

Frequent flyer miles. To date, the IRS has not taken any action to tax frequent flyer miles.

Employment-related tax credits. The following tax credits, which expired at the end of 2020, have been extended. The Indian employment credit is extended through 2021. There is a 5-year extension for the paid family and medical leave credit (not the COVID-related paid sick leave and paid family leave) and the work opportunity credit. The empowerment zone employment credit has not been extended

The employee retention credit created by the CARES Act, which had been set to expire at the end of 2020, has been extended through June 30, 2021. What's more, the credit has been expanded considerably in the following ways:

- The credit rate has increased to 70% (up from 50%) of qualified wages.
- Qualified wages include group health costs, even if no other wages are paid.
- The credit limit is increased from $10,000 for the year for each employee with creditable wages to $10,000 per quarter.
- The required year-over-year reduction in gross receipts in order to qualify for the credit is reduced to 20% (down from 50%). There is a safe harbor to use prior-quarter gross receipts.
- Businesses that were not in existence for some or all of 2019 may still be able to claim the credit.
- Employers obtaining PPP loans can claim the employee retention credit if eligible. However, they cannot claim the credit with respect to wages covered by PPP loan forgiveness.

A different employee retention credit is available for employers in disaster areas (other than COVID-19). This is an income tax credit and is explained in Chapter 17 of this Supplement.

Chapter 8—Travel, Meals, and Gift Expenses

Business travel per diem rates. The standard federal per diem rate for travel starting October 1, 2020, through September 30, 2021, covering lodging and meals and incidental expenses (M&IE) within the continental United States (CONUS) in most locations is $151 per day ($96 for lodging and $55 for M&IE). These basic rates are unchanged from the prior 12-month period; 319 locations have a per diem rate exceeding the standard rate for all or part of the year. These rates can be found here.

The high-low substantiation rates for areas within CONUS for the period October 1, 2020, through September 30, 2021, are $292 for travel to high-cost localities and $198 for travel to all other areas within CONUS. Of these rates, the meal portion is $71 for high-cost areas and $60 for all other areas within CONUS. The list of high-cost areas has been changed (see Notice 2020-71 for details).

Meals. The deduction for business meals is allowed up to 100% of costs for 2021 and 2022 for meals provided at restaurants. CCA does not define the term "restaurant," so look for IRS guidance on this term. The 50% limit continues to apply for business meals in 2020; the increased limit does not impact 2020 returns. The bar to deducting entertainment costs has not been changed; no deduction is allowed.

Chapter 9—Car Expenses

Section 179 deduction and bonus depreciation. For 2021, the first-year expense allowance (Section 179 deduction) applies to equipment purchases (e.g., new vehicles) up to $1,050,000. However, this dollar limit phases out dollar for dollar when purchases for the year exceed $2,620,000. Thus, no expensing deduction can be claimed if equipment purchases for the year are $3,670,000 million or more.

Heavy SUVs are not subject to the dollar limits, but the first-year expense deduction is limited to $26,200 in 2021 ($300 more than for 2020).

Standard mileage rate. The IRS announced the standard mileage rate, used in lieu of deducting the actual costs of business driving; for 2021 it is 56¢ per mile (down from 57.5¢ per mile in 2020).

Those who own their vehicles and use the standard mileage rate for 2021 must reduce the vehicle's basis by 26¢ per mile (down from 27¢ per mile in 2020).

2-wheel vehicles. The credit for a 2-wheel plug-in electric vehicle, which expired at the end of 2020, has been extended through 2021.

Chapter 10—Repairs, Maintenance, and Energy Improvements

The deduction for energy-efficient commercial buildings at $1.80 per square foot deduction for commercial buildings that achieve at 50% energy-saving target, which had expired at the end of 2020, has been made permanent. What's more, the $1.80 per square foot amount used to figure the deduction will be adjusted for inflation starting in 2021. Look for an IRS announcement on the applicable amount for 2021.

The alternative fuel vehicle refueling property credit, which expired at the end of 2020, has also been extended through 2021.

Chapter 12—Rents

PPP loans and deduction for rents. The IRS had ruled that if forgiveness was obtained or reasonably expected for loans obtained a loan under the Paycheck Protection Program, then rents covered by the loan would not be deductible in 2020. CAA repealed this bar to deductibility. This means obtaining loan forgiveness does not block a deduction for rents.

Rent for employee parking. Final regulations on the treatment of rent that covers free parking for employees were issued on December 9, 2020. They generally follow the rules covered by proposed regulations (explained in this chapter in the book). The final regulations make some minimal modifications to various definitions that impact the deduction for rent with respect to employee parking. The final regulations apply to taxable years ending after December 31, 2019 (i.e., 2020 tax years for calendar year businesses).

Chapter 13—Taxes and Interest

State and local income taxes. The IRS said that state and local income taxes imposed on and paid by a partnership or S corporation is not subject to the SALT cap and allowed in computing non-separately stated income or loss for the entity (and passed through to the owner).

Self-employment tax. The Social Security wage base limit, which applies for self-employment taxes, is $142,800 in 2021 (up from $137,700 in 2020). The tax rate for the Social Security portion of self-employment tax is 12.4% on net earnings up to this dollar limit. The tax rate for the Medicare portion of self-employment tax is 2.9% on all net earnings. The tax deduction is limited to one-half of the self-employment tax. This is so even if deferral is used for one half of the Social Security tax portion of self-employment tax. The maximum deferral amount for 2020 is figured in Part III of Schedule SE.

For those with net earnings over the applicable threshold amount of $200,000 for singles and $250,000 for joint filers (these dollar limits are not adjusted annually for inflation), there is also a Medicare surtax of 0.9% on excess earnings. This applies only to the so-called employee portion, so it is *not* deductible.

Employment taxes—FICA. The wage base limit for the Social Security portion of FICA in 2021 is $142,800 (up from $137,700 in 2020). The rate for the employee's Social Security portion of FICA is unchanged at 6.2%.

> ***Reminder***: Any employer that opted to defer the employee's share of Social Security taxes on wages earned from September 1, 2020, through December 31, 2020, should withhold sufficient amounts to cover the deferred taxes. CAA allows withholding for these deferred taxes through December 31, 2021. If an employer fails to fully deposit them, then taxes, interest, and penalties on the employer begin to accrue on January 1, 2022.

Employment taxes—FUTA tax. For purposes of FUTA in 2020, there are no "credit reduction states." However, anticipate that there will be a number of credit reduction states in 2021 due to high unemployment claims resulting from the pandemic.

Interest expense payments. For 2021, the special rules for the net interest expense limit that had applied in 2020 revert to the original rules. This means that for 2021, net business interest expense over 30% of adjusted taxable income is not deductible. This net interest expense disallowance rule applies at the owner level for pass-through entities, but there is a special rule that applies at the entity level. However, there is an exemption from the interest expense limit for small businesses, which in 2021 are those with average annual gross receipts for the 3 prior years not exceeding $26 million (unchanged from 2020).

Chapter 14—First-Year Expensing, Depreciation, Amortization, and Depletion

First-year expensing. The expensing limit for 2021 is $1,050,000. The limit phases out when purchases for the year exceed $2,620,000. Thus, no expensing can be used if purchases for the year $3,670,000 million or more.

Modified accelerated cost recovery system—recovery periods. Special recovery periods for the following types of property expired at the end of 2020. They have been extended:

- 3-year recovery period for racehorses 2 years or younger is extended through 2021.
- 7-year recovery period for motorsports entertainment complexes has been extended for 5 years (through 2025).

Chapter 16—Retirement Plans

Contribution limits. Various limits have been increased for 2021, although some are unchanged from 2020. The following apply to 2021 (not to 2020 returns):

- 401(k) plan elective deferrals: $19,500, plus $6,500 for those who are age 50 and older by December 31, 2021 (both limits are unchanged from 2020).
- Savings incentive match plan for employees (SIMPLE) elective deferrals: $13,500, plus $3,000 for those who are age 50 and older by December 31, 2021 (both limits are unchanged from 2020).
- Defined contribution plans (profit-sharing plans and simplified employee pension plans [SEPs]): the limit is $58,000 (up from $57,000 in 2020).
- Defined benefit (pension) plans: the limit is $230,000 (unchanged from 2020).
- Compensation taken into account in figuring contributions and benefits: the limit is $290,000 (up from $285,000 in 2020).
- IRAs: the contribution limits for 2021 are $6,000, plus $1,000 for those age 50 or older by December 31, 2021 (both limits unchanged from 2020). However, the adjusted gross income limits for making deductible contributions for those who are active participants in qualified retirement plans have been increased slightly.

Corrections: The AGI phase-out for a self-employed person with no retirement plan married to a spouse who is an active participant referenced on page 394 should be $196,000 (not $193,000). Table 16.3 on page 402 should read MAGI Phase-Outs for Making Roth IRA Contributions in 2020.

PBGC premiums. For planning purposes, in 2021 the flat-rate premium for each participant is $86 (up from $83 in 2020). The variable rate premium for underfunded plans is $46 per $1,000 of unfunded benefits per employee (up from $45), with a cap of $582 per participant (up from $561).

Plan amendments. The IRS intends to publish a list each year of required amendments for individually-designed retirement plans. The list for 2020 includes updates to pre-approved defined benefit plans (see Notice 2020-14). Check for the cumulative list of required amendments here. If you use a prototype plan, which is one provided to you from the financial firm with which you maintain your plan, you will automatically receive documents reflecting plan amendments; you do not have to do anything other than retain the revised documents in your records.

Chapter 17—Casualty and Theft Losses

Disaster losses. Find a list of all federal disaster areas for 2020 from FEMA https://www.fema.gov/disasters/disaster-declarations. Designated disasters in 2021 will be listed by FEMA.

Special disaster loss relief. For any major disaster (other than COVID-19) between January 1, 2020, and February 25, 2021, helpful provisions for businesses and their employees include:

- ***Employee retention credit.*** A business operating in a qualified disaster zone and became inoperable due to a federal disaster may claim an income tax credit of 40% of qualified wages (up to $6,000 per employee). The credit may be claimed without regard to whether the employee performs any services in order to receive the wages. This credit is subject to the general business credit limitation and requires the employer to reduce the deduction for employee compensation by the amount of the credit (even if the general business credit limitation applies). The general business credit limitation is explained in Chapter 23. The reference on page 573 to "a prior employee retention credit" is, in fact this employee retention credit, but for disasters occurring in a different period.
- Note: This employee retention credit is *not* the same as the employment tax-related employee retention credit for retaining employees related to COVID-19.
- ***Distributions and loans.*** Distributions from qualified retirement plans and IRAs are allowed up to $100,000 without incurring the 10% early distribution penalty. Amounts withdrawn are included ratably in gross income over 3 years. The withdrawn funds can be recontributed to the same or other qualified retirement plan or IRA within 3 years. These breaks mirror the distribution provisions in the CARES Act for COVID-19-related purposes.
- ***Charitable contributions.*** Charitable contribution limits are increased to 100% of a C corporation's taxable income (similar to CARES Act relief for COVID-19).

Extended period for filing returns. See Chapter 31.

Chapter 19—Medical Expenses

Employer mandate. At this time, a case challenging the constitutionality of the Affordable Care act had been argued before the U.S. Supreme Court. To date, no decision has been announced.

Small employer health care credit. Small employers can take this tax credit only if average annual payroll is below a set amount. This amount has been adjusted for inflation so that the full credit applies if the average annual payroll in 2021 is $27,800. No credit can be claimed for 2021 if the average annual payroll is $55,600 or more.

Qualified small employer health reimbursement arrangements (QSEHRAs). These reimbursement plans are a way for small employers to help employees pay for the cost of health coverage. For 2021, reimbursements to employees are capped at $5,300 for self-only coverage and $10,700 for family coverage.

Health savings accounts. The contribution limit for 2021 increases to $3,600 for self-only coverage; the limit for family coverage increases to $7,200. Those who are age 55 or older by the end of 2021 can add another $1,000 for the year (this additional contribution limit is unchanged and married persons must have separate accounts to each use the additional limit).

To contribute to a health savings account, the person must be covered by a high-deductible health plan. For 2021, this means that the plan has a minimum deductible of $1,400 for self-only coverage and $2,800 for family coverage. The cap on annual out-of-pocket expenses (deductibles, co-payments, and other amounts) cannot exceed $7,000 for self-only coverage and $14,000 for family coverage.

Flexible spending arrangements (FSAs). The maximum amount that employees can add to a medical FSA in 2021 is $2,750 (unchanged from the 2020 limit). Other changes related to FSAs are discussed in Chapter 7, above.

Chapter 20—Deductions for Farmers

Depreciation. The 3-year depreciation recovery period for racehorses 2 years or younger, which had expired at the end of 2020, has been extended for 2021.

Net operating losses. See the discussion in Chapter 4, above.

Chapter 21—Qualified Business Income Deduction

Qualified trade or business. Losses, which many pass-through businesses experienced in 2020, impact the QBI deduction and amended and proposed regulations clarify their treatment.

Generally, previously disallowed losses due to the taxable income limitation, and the formula that applies to those with taxable income above the applicable threshold amount, are taken into account in the following year, although pre-2018 losses aren't considered.

Business losses disallowed because of the rule barring excess business losses of noncorporate taxpayers (a rule that didn't apply for 2018, 2019, and 2020), are factored into the QBI deduction after 2020. Such excess business losses are treated as a net operating loss carryover in a subsequent year.

Previously disallowed losses or deductions under the at-risk rules, the passive activity loss rules, or limited by Code Sections 704(d) and 1366(d) are taken into account for computing QBI, using the following rules:

- Losses are used in the order from the oldest to the most recent, which is a FIFO basis. FIFO rule applies per category; you can't put all the disallowed or suspended losses into a single bucket.
- Previously disallowed losses or deductions are treated as losses from a separate trade or business in the year they are taken into account in determining taxable income.
- Attributes, such as whether a deduction is attributable to a trade or business, are determined in the year the loss or deduction is incurred.

Under new final regulations, if an owner of a specified service trade or business (SSTB) has taxable income at or below the threshold amount in the year the loss or deduction is incurred and such amount would otherwise be QBI, then the entire disallowed loss or deduction is treated as QBI from a separate trade or business in the subsequent year when the loss or deduction is allowed. For an owner within the phase-out range, only the applicable percentage of the disallowed loss or deduction is taken into account in subsequent year. For an owner with taxable income in excess of the phase-out range, none of the disallowed loss or deduction is taken into account in the subsequent year.

Taxable income threshold for 2021. The taxable income threshold for the QBI deduction is $329,800 for joint filers, $164,925 for married filings separately, and $164,900 for all other filers.

W-2 wages for certain businesses. The IRS has provided guidance on figuring W-2 wages for agricultural and horticultural cooperatives.

Chapter 22—Miscellaneous Business Deductions

Personal education incentives for 2021:

- ***American opportunity credit.*** The basic credit amount and modified adjusted gross income limit on eligibility are unchanged.
- ***Lifetime learning credit.*** The modified adjusted gross income threshold for phasing out the credit has been aligned with the MAGI limits for the American opportunity credit. This means the phaseout limits for 2021 are $80,000 to $90,000 for singles and $160,000 to $180,000 for joint filers. Prior to the law change, the limits had been set to be $59,000 to $69,000 for singles and $119,000 to $139,000 for joint filers in 2021.
- ***Above-the-line deduction for tuition and fees.*** This break expired at the end of 2020; it has *not* been extended.
- ***Student loan interest.*** The 2021 modified adjusted gross income range over which the deduction limit of up to $2,500 of interest is phased out is $140,000 to $170,000 on a joint return; for singles it is $70,000 to $85,000. These dollar amounts are unchanged from 2020.

Legal and professional fees. If you win a dispute with the IRS in which the government was not substantially justified, you may be able to recover costs up to a set dollar amount. For 2021, the dollar amount is $210 per hour (unchanged from 2020).

Meal costs for day care providers. For 2021, the rates for standard meals and snack rates in all localities have increased slightly. They are:

Breakfast:

- States other than Alaska and Hawaii: $1.39
- Alaska: $2.22
- Hawaii: $1.62

Lunch and dinner:

- States other than Alaska and Hawaii: $2.61
- Alaska: $4.24
- Hawaii: $3.06

Snacks:

- States other than Alaska and Hawaii: $0.78
- Alaska: $1.26
- Hawaii: $0.91

Chapter 23—Roundup of Tax Credits

Many tax credits expired at the end of 2020. Most, but not all of the credits, have been extended. The following shows the period of extension:

5-year extension:

- Paid family and medical leave credit.
- Work opportunity credit.
- New markets credit

2-year extension:

- Energy investment tax credit for solar property.
- Carbon oxide sequestration credit.

1-year extension:

- Indian employment credit.
- Energy-efficient home credit.
- Credit for qualified fuel cell motor vehicles.
- Alternative fuel vehicle refueling property credit.
- Credit for 2-wheeled plug-in electric drive vehicles
- Production credit for Indian coal facilities.
- Second generation biofuel producer credit.
- Credit for electricity produced from certain renewable sources
- Mine rescue training credit.

The empowerment zone employment credit, which expired at the end of 2020, has *not* been extended. The railroad track maintenance credit has been made permanent, but the credit rate is reduced from 50% to 40%.

Chapter 24—Income and Deduction Strategies

Meals deduction. For 2021 and 2021, 100% of business meal costs are deductible, as long as the meals are provided at restaurants. See Chapter 8 above.

Chapter 26—Strategies for Opening or Closing a Business

Shareholder basis in stock. The AICPA suggestion to the IRS to provide a new tax form for tracking a shareholder's basis in S corporation stock and debt has yet to be acted upon.

Crowdfunding. The SEC is amending rules to eliminate complexity and make other changes to crowdfunding, increasing access to capital by small businesses. Details of new amendments can be found here.

Chapter 28—Tax Strategies for Multiple Businesses

Employer mandate. See the discussion in Chapter 19.

Chapter 29—Alternative Minimum Tax

Exemption amounts. The AMT exemption amounts for 2021 are:

Filing status	2021 exemption
Married filing jointly/surviving spouse	$114,600
Single/head of household	$73,600
Married filing separately	$57,300

Exemption phase-out. The exemption amounts for 2021 start to phase out when alternative minimum taxable income (AMTI) exceeds $1,047,200 for married filing jointly and surviving spouses and $523,600 for other filers.

Chapter 30—Other Taxes

State income taxes. There have been some tax changes for businesses at the state and local levels. For example, New Mexico changed the scope of its gross receipts tax effective July 1, 2021. Check with state tax departments in all locations in which you do business to learn if there have been any tax changes impacting your business.

Employment and self-employment taxes. The 2021 wage base limit for the Social Security tax portion of FICA and self-employment tax is $142,800 (up from $137,700 in 2020).

For employers that opted to defer the *employee* share of Social Security taxes (part of FICA) on certain wages from September 1, 2020, through December 31, 2020, must be paid in 2021. Employers should withhold and deposit additional amounts throughout 2021 to recoup the deferred taxes. If employers don't withhold and deposit these deferred taxes, then interest, penalties, and additions to tax begin to accrue on January 1, 2022.

Sales taxes. A number of states have changes in sales tax rules for 2021. Check with your state finance/revenue/tax division.

Congress has not yet enacted a bar to states retroactively imposing sales tax on remote sellers. Congress has not enacted any requirement for states to have uniform sales tax rules for remote sellers.

Chapter 31—Filing Tax Returns, Paying Taxes, and Making Refund Claims

Filing extensions. There is an automatic 60-day extension for owners and businesses within a disaster area. Regulations clarify that the IRS still has authority to provide even greater extensions. Monitor the IRS webpage on tax relief in disaster situations for the extensions related to a specific disaster.

Gaming Industry Tip Compliance Agreement (GITCA). The IRS modified GITCA used by employers in the gaming industry to promote the reporting of tip income. In general, the agreement with the IRS runs for 5 years and may be renewed for additional terms. New properties and those without a prior agreement in place, may have a shorter initial term.

Paying taxes by credit card. As yet, the IRS does not accept payment directly through a credit card. You still need to go through an IRS-authorized credit card processor.

Estimated taxes. If you underpaid estimated taxes for 2019 (not 2020) because of anticipating having a lower required annual estimated tax payment due to an NOL carryover attributable to the excess business loss limit for noncorporate taxpayers (e.g., owners of LLCs and S corporations), the IRS is waiving a related underpayment penalty. However, the IRS is not waiving any penalty attributable to CARES Act changes to NOL carrybacks.

Chapter 32—Retirement and Succession Planning

2021 limits on earnings for those working while receiving Social Security benefits. There is no limit on those who have attained full retirement age. For those who receive benefits and are under full retirement age, the earnings limit in 2021 is $1,580 per month ($18,960 for the year).

If earnings exceed this limit, then benefits are reduced by $1 for each $2 of excess earnings. For the year in which you reach full retirement age, the earnings limit is $4,210 per month ($50,520 for the year). If earnings for the month prior to attaining full retirement age exceed the limit, benefits are reduced by $1 for each $3 of excess earnings.

Chapter 33—Working with CPAs and Other Tax Professionals

PTINs. The fee charged by the IRS for a tax preparer to obtain a PTIN for the 2021 tax season is $35.95.

Chapter 34—Handling Audits with the IRS

Small business audits. In November 2020, the IRS announced that it planned to increase audits of small businesses by 50% starting in 2021. No further details have been provided, so it is unclear what the IRS will be focusing on. Keep in mind that because audit rates have been so low in recent years, a 50% increase is not very significant. For example, in 2018, the IRS audited fewer than 400 S corporation returns (about 0.01% of all such returns filed).

Appendix A—Information Returns

Wages. The Taxpayer First Act changed the number of returns for which electronic filing is required:

- For calendar years beginning before 2021: 250
- For calendar year 2021: 100
- For calendar years beginning after 2021: 10

Appendix B—Tax Penalties

The following penalties apply to 2021 returns required to be filed in 2022:

Failure to file a tax return. The penalty is $435 or 100% of the amount required to be shown on the return.

Failure of a partnership to file a return. The penalty is $210. The penalty is per month (or part-month) that the return is late, up to a maximum of 12 months, and is multiplied by the number of partners during any part of the year.

The penalty for a failure to furnish a Schedule K-1 is $280 for each failure, up to a maximum of $3,426,000 ($1,142,000 for businesses with average annual gross receipts in the 3 most recent years of $5 million or less). The penalty is increased to $570, or, if greater, 10% of the aggregate amount of items required to be reported, if the failure is due to intentional disregard of the reporting requirement; there is no maximum annual limit.

Failure of an S corporation to file a return. The penalty is $210. The penalty is per month (or part-month) that the return is late, up to a maximum of 12 months, and is multiplied by the number of shareholders during any part of the year.

The penalty for a failure to furnish a Schedule K-1 is $280 for each failure, up to a maximum of $3,426,000 ($1,142,000 for businesses with average annual gross receipts in the 3 most recent years of $5 million or less). The penalty is increased to $570, or, if greater, 10% of the aggregate amount of items required to be reported, if the failure is due to intentional disregard; there is no annual cap.

Administrative waivers. To date there have been no developments on an SB/SE Division program for self-correcting errors.

Self-correct program. There are still no additional details on the SB/SE Division's program to enable small businesses and self-employed individuals to self-correct errors on their tax returns with minimal or no penalties. This proposal has been around for a couple of years with no developments.

Appendix D—Dollar Limits and Amounts Adjusted for Inflation

Items Adjusted Annually for Inflation. The following adjustments apply for 2021 (and do not factor into the preparation of 2020 returns).

Adoption assistance—excludable employer-provided adoption assistance for employees ($14,440 for 2021).

Cash method of accounting—the gross receipts test for eligibility of C corporations and partnerships with C corporation partners to use the cash method of accounting is average annual gross receipts in the 3 prior years not exceeding a set amount ($26 million in 2021).

Excess business losses for noncorporate taxpayers—the threshold used in determining whether an owner of a pass-through entity has such losses is capped on their personal returns at a set amount ($524,000 for joint filers and $262,000 for other filers in 2021).

First-year expensing (Sec. 179 deduction)—the dollar limit on the deduction, as well as the phase-out on property placed in service for 2021 are $1,050,000 and $2,620,000, respectively.

Foreign earned income exclusion—the amount of wages or self-employment income earned abroad eligible for the exclusion is limited ($108,700 in 2021).

Medical flexible spending accounts (FSAs)—the most that employees can add annually on a pretax basis is capped at $2,750 for 2021.

Qualified business income deduction—the taxable income limit for the 20% deduction before application of a formula is required (and a phase-out for owners in specified service trades or businesses) is $329,800 on joint returns, $164,925 for married persons filing separately, and $164,900 for other filers in 2021.

Small employer health insurance credit—the amount of average compensation, originally fixed at $25,000, is $27,800 for 2021.

Social Security wage base—the amount that is used to figure the Social Security portion of FICA and self-employment tax ($142,800 for 2021).

Transportation fringe benefits—the amount excludable for free parking, and the aggregate amount excludable for transit passes or van pooling, is $270 per month in 2021.

Items set by the IRS. The following adjustments apply for 2021 (and do not factor into the preparation of 2020 returns):

> ***Deemed depreciation for business vehicles***—if the deduction for expenses for business use of a personal vehicle owned by the taxpayer is figured using the IRS's standard mileage allowance, then the basis of the vehicle is reduced by a set amount per mile (e.g., 26¢ per mile in 2021).
>
> ***Mileage allowance***—the rate per mile used to determine the deduction for business use of a personal vehicle instead of deducting the actual costs is 56¢ per mile in 2021.