Consider tax accounting method changes and strategic tax elections

The 2017 Tax Cuts and Jobs Act (TCJA) lowered the regular corporate tax rate to 21% and eliminated the corporate alternative minimum tax beginning in 2018. The current version of the proposed Build Back Better Act would leave the 21% regular corporate tax rate unchanged but, beginning in 2023, would create a new 15% corporate alternative minimum tax on the adjusted financial statement income of corporations with such income over $1 billion. Companies with adjusted financial statement income over $1 billion, therefore, should take into account the proposed 15% corporate alternative minimum tax when considering 2021 tax planning actions that could affect future years.

Companies that want to reduce their 2021 tax liability should consider traditional tax accounting method changes, tax elections and other actions for 2021 to defer recognizing income to a later taxable year and accelerate tax deductions to an earlier taxable year, including the following:

- Changing from recognizing certain advance payments (e.g., upfront payments for goods, services, gift cards, use of intellectual property, sale or license of software) in the year of receipt to recognizing a portion in the following taxable year.
- Changing from the overall accrual to the overall cash method of accounting.
- Changing from capitalizing certain prepaid expenses (e.g., insurance premiums, warranty service contracts, taxes, government permits and licenses, software maintenance) to deducting when paid using the “12-month rule.”
- Deducting eligible accrued compensation liabilities (such as bonuses and severance payments) that are paid within 2.5 months of year end.
- Accelerating deductions of liabilities such as warranty costs, rebates, allowances and product returns under the “recurring item exception.”
- Purchasing qualifying property and equipment before the end of 2021 to take advantage of the 100% bonus depreciation provisions and the Section 179 expensing rules.
- Deducting “catch-up” depreciation (including bonus depreciation, if applicable) by changing to shorter recovery periods or changing from non-depreciable to depreciable.
- Optimizing the amount of uniform capitalization costs capitalized to ending inventory, including changing to simplified methods available under Section 263A.
- Electing to fully deduct (rather than capitalize and amortize) qualifying research and experimental (R&E) expenses attributable to new R&E programs or projects that began in 2021. Similar planning may apply to the deductibility of software development costs attributable to new software projects that began in 2021. (Note that capitalization and amortization of R&E expenditures is required beginning in 2022, although the proposed Build Back Better Act would delay the effective date until after 2025).
- Electing to write-off 70% of success-based fees paid or incurred in 2021 in connection with certain acquisitive transactions under Rev. Proc. 2011-29.

- Electing the de minimis safe harbor to deduct small-dollar expenses for the acquisition or production of property that would otherwise be capitalizable under general rules.

Is “reverse” planning better for your situation?

Depending on their facts and circumstances, some businesses may instead want to accelerate taxable income into 2021 if, for example, they believe tax rates will increase in the near future or they want to optimize usage of NOLs. These businesses may want to consider “reverse” planning strategies, such as:

- Implementing a variety of “reverse” tax accounting method changes.
- Selling and leasing back appreciated property before the end of 2021, creating gain that is taxed currently offset by future deductions of lease expense, being careful that the transaction is not recharacterized as a financing transaction.
- Accelerating taxable capital gain into 2021.
- Electing out of the installment sale method for installment sales closing in 2021.
- Delaying payments of liabilities whose deduction is based on when the amount is paid, so that the payment is deductible in 2022 (e.g., paying year-end bonuses after the 2.5-month rule).