

Tax Planning for 2022 and Beyond

Southern California Veterinary Medical Association
Webinar
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1

Tom A. McFerson, CPA, ABV



- Mr. McFerson is the primary shareholder at Gatto McFerson, CPAs, a veterinary-focused financial and consulting firm located in Los Angeles, California.
- He is accredited in business valuations by the American Institute of Certified Public Accountants, and is a former director and active member of Vet Partners.
- Grew up in Fresno, California.
- Graduated from Loyola Marymount University in Los Angeles, California.
- Outside of work, Tom plays a lot of tennis, is an active dad with his three kids, and loves to travel with his wife and family, which includes a lovable lab.

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2

Before we get into taxes...

Employee Retention Credits

California Education Letters

Pass-Through Entity Credit

State of the Veterinary Economy

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3

Employee Retention Credits

Please be careful...

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Employee Retention Credits

The ERC was introduced in March 2020 as part of the CARES Act.

Meant to assist businesses that continued paying employees while their doors were shut or while they were experiencing significant declines in gross receipts.

To qualify:

1. experienced a significant decline in gross receipts during 2020 and the first three quarters of 2021
2. sustained a full or partial suspension of operations due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings due to COVID-19 during 2020 or the first three quarters of 2021,

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Employee Retention Credits

- For most businesses, the credit applies to wages paid between March 13, 2020 and Sept. 30, 2021.
- The credit is tied to payroll and is calculated quarterly.
- Businesses that didn't claim the credit when filing their original returns can file amended tax returns.
- The usual rules apply, which means that you typically must file Form 941-X within three years of filing or two years from the date the tax was paid, whichever is later.

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6

Employee Retention Credits

Please be careful...

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Employee Retention Credits

- This month, the IRS warned that "some third parties are taking improper positions related to taxpayer eligibility for and computation of the credit."
- Fraud related to the program is estimated to be approaching one trillion dollars. Has the attention of IRS
- Taxpayers are always responsible, the IRS notes, for the information reported on their tax returns. Improperly claiming the ERC could result in repayment of the credit, plus penalties and interest. If you're already out fees paid to a third party, it's even more painful.

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8

Employee Retention Credits

If you are eligible, don't expect cash immediately.

As of Oct. 12, 2022, the IRS had 3.4 million unprocessed Forms 941 and 219,000 unprocessed Forms 941-X.

Like a corporate or individual tax return, no supporting documents required for the IRS to verify the credit calculations before issuing a refund check, you only have to show your work if they come knocking on your door to audit you.

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9

Employee Retention Credits

Do you qualify?

"Drop in revenue" is easy to quantify.

"Sustained a full or partial suspension of operations due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings due to COVID-19 during 2020 or the first three quarters of 2021" harder to quantify.

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10

Employee Retention Credits

Do you qualify?

A portion of the business must be suspended, not just disrupted. For example, an accounting firm that switched from in-person to remote meetings was merely disrupted, not suspended, and would not qualify.

Evidence that the business was more than nominally impacted by the referenced government order. The IRS defines this as greater than 10% overall impact on either revenue or hours compared to the same period in 2019, but other interpretations could apply.

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11

Employee Retention Credits

Recommendations:

- Plenty of time before deadline to file. The deadline to apply for 2020 isn't until April 2024, and you have until April 2025 to submit applications pertaining to 2021.
- Make sure company filing your ERC claim provides you with documentation and an analysis proving you're eligible.
- Ask if the company provides audit protection. The IRS is backlogged now, but they are beefing up staff to focus on Covid-19-related fraud.
- Remember, if you receive an ERC, you must pay tax on it. If the IRS one day determines your ERC should have never been paid, you will lose that money, be subject to fraud penalties, but you also will have to try to recoup the tax paid on that credit. And good luck getting your ERC fees back.
- Do your own smell test. Too good to be true?

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12

Employee Retention Credits

Please be careful...

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California Education Letters

The Franchise Tax Board has been sending Education Letters to certain taxpayers, asking them to review the expenses claimed on either their Schedule A (Itemized Deductions) or Schedule C (Self-Employed Business) for 2019 and/or 2020.

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14

California Education Letters

These letters are understandably causing stress for their recipients.

These are basically “fishing” letters, meant to beat the bushes and get certain taxpayers to step forward and amend their tax returns.

The Franchise Tax Board has said that these letters are purely educational, and they do not represent any sort of audit nor do they increase your chances of being selected for an audit.

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15

Pass-Through Entity Credit

Several states, including California, have recently enacted legislation that allows S-Corporations and partnerships to pay state income taxes at the business level via their Pass-Through Entity (PTE) tax return - Form 1120S or Form 1065.

This treatment allows state taxes paid at the entity level to be deductible by the shareholder/partner for Federal income tax purposes. This “work-around” was designed to avoid the current \$10,000 limitation on the deductibility of state and local taxes for Federal tax purposes.

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16

Pass-Through Entity Credit

To be eligible to take credit for 2022 tax year, you would need to have already made a payment by June 15, 2022.

This payment would have been the greater of:

\$1,000 or

50% of your 2021 PTE credit

[Details to follow later in Webinar](#)

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17

General Economy in a Nutshell

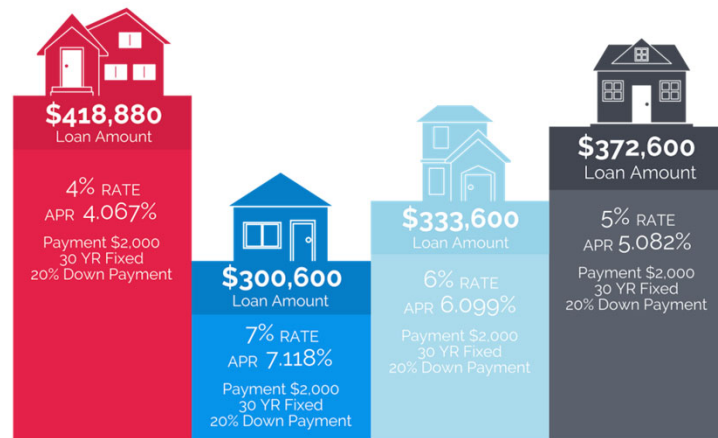
- Unemployment is Down
- Interest Rates are Up
- Consumer Spending is Sideways
- Home Values are Dropping
- Stock Market is Down
- Inflation is Up
- Recession is Looming

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Impact of Rising Interest Rates

(A/P)



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Veterinary Economy in a Nutshell

- Pet Ownership is Up
- Demand for Service is Up
- Profitability is Sliding
- Practice Value is Sliding
- Financing is Tightening
- Availability of Labor is Down
- Stress Level is Up

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Veterinary Labor Market

- Incredibly High Demand
- Shortage of Candidates
- Salaries Rising
- Benefits Increasing
- Consolidators Tipping Scales
- Flexible Schedules
- Competitive

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21

Taxes!!

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Remember when...

About two years ago, panic in the streets about taxes.

- Biden elected.
- Congress Blue
- Corporate tax increase imminent
- Big wave of individual tax increases also coming
- \$400,000 was magic number

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Remember when...

About two years ago, panic in the streets about taxes.

- PPP needed to be paid for
- Capital gains skyrocketing
- Higher ordinary tax rates
- Capped itemized deductions
- Etc., etc., etc.

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Now...

- Bi-partisan infrastructure bill passed. Basically tax neutral
- Other smaller, less dramatic tax changes
- Taxes on back-burner as other issues have emerged:
 - Russia
 - Inflation
 - Interest Rates
 - Elections

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25

Taxes

No Changes to Top Income Tax Rate

The plan was to increase the top income tax rate from 37% to 39.6% for those with taxable incomes above \$400,000.

This has been dropped entirely. It appears ordinary income tax rates and their corresponding thresholds will remain the same.

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26

Taxes

Single taxpayers

Taxable income over	But not over	Is taxed at
\$0	\$10,275	10%
\$10,275	\$41,775	12%
\$41,775	\$89,075	22%
\$89,075	\$170,050	24%
\$170,050	\$215,950	32%
\$215,950	\$539,900	35%
\$539,900		37%

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Taxes

Married filing jointly

Taxable income over	But not over	Is taxed at
\$0	\$20,550	10%
\$20,550	\$83,550	12%
\$83,550	\$178,150	22%
\$178,150	\$340,100	24%
\$340,100	\$431,900	32%
\$431,900	\$647,850	35%
\$647,850		37%

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Taxes

Keep in Mind...

These taxable income thresholds aren't all or nothing. You only pay tax at the higher rate on the income that exceeds the corresponding threshold. Marginal.

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Taxes

Year-End

Given that it now appears rates will remain the same next year, consider pushing income into 2023 and/or accelerating expenses into 2022.

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Taxes

No Changes to Long-Term Capital Gains/Qualified Dividends

- The plan was to tax capital gains and qualified dividends at ordinary income tax rates if the taxpayer's income was over \$400,000, almost doubling the tax on this type of income.
- That idea has also been dropped. It appears long-term capital gain rates will remain the same.

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31

Taxes

No Changes to Long-Term Capital Gains/Qualified Dividends

- Even though the stock market has been weak, consider pushing gains into 2023 and/or realizing losses in 2022.
- Also, the rush to close a business sale by the end of the year has been greatly diminished. In fact, if capital gain rates do remain unchanged, then pushing a sale off to early 2023 might be the better play.

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32

Taxes

E-Filing and Direct Deposits Highly Recommended

According to the IRS, tax returns that are paper filed, and/or refunds using paper checks will take much longer to process this year. Filing electronically and opting to receive refunds via direct deposit will significantly decrease the processing time.

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Student Loan Payment Exclusion

One piece of legislation that doesn't get much attention is Section 2206 of the CARES Act, which allows employers to make up to \$5,250 in tax-free annual payments directly to their employees or their employees' federal student loans.

These payments represent the best of both worlds. Employees don't pay tax on this added "income," and employers can still deduct these payments while not paying additional payroll taxes on these funds.

The provision has been extended until December 31, 2025.

Nice recruiting tool for attracting and retaining employees.

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34

Taxes

Internal Revenue Service received additional funding for 2023 and beyond.

Increased budget for agents/technology/collections.

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Taxes

- Classic audit virtually extinct;
 - IRS office/Boxes of receipts
- Shifting toward electronic verification
 - Covid;
 - Shortage of resources;
 - Document (W2s, 1099s) matching;
- Red Flag audits – something stands out
- Random audits – chances slim

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36

Taxes

Audit Chart

Business/specialty taxpayer types, in descending likelihood of audit	Returns audited
Large corporations (Form 1120, assets greater than \$5 billion)	1 in 3
Estate tax returns	1 in 12
Large corporations (Form 1120, assets between \$10 million and \$5 billion)	1 in 23
Excise tax returns	1 in 72
Gift tax returns	1 in 130
Small corporations (Forms 1120, not 1120-S)	1 in 146
OVERALL CORP/PARTNERSHIP AUDIT RATE	1 in 224
Partnership returns (Form 1065)	1 in 260
Estate and trust income tax returns (Forms 1041)	1 in 971
Employment tax returns (Forms 940 and 941)	1 in 568
S corporation returns (Forms 1120-S)	1 in 358

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Section 179/Bonus Depreciation – New Equipment/Assets

- Still one of the best tax planning tools for small businesses.
- Veterinary practices can write-off the cost of qualifying new equipment (digital x-ray or computers, for example) placed in service, up to \$1,080,000 in a given year.
- Bonus Depreciation allows practice owners to also write-off longer term assets such as improvements and furnishings.

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38

Section 179/Bonus Depreciation – New Equipment/Assets

- This provision provides financial assistance to veterinarian looking to improve or expand her/his practice.
- Can finance equipment, get full write-off with very little money spent up front.
- As long as the equipment is signed for and in service by the end of the year, this deduction can be taken.
- Equipment acquired through a capital lease also qualifies.

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39

Retirement Plans - 2023

The IRS has significantly increased the contribution limits for 2023 retirement plans, as follows:

IRA contributions have been increased to \$6,500 (up from \$6,000 for 2022). The \$1,000 IRA catch-up contribution limit for those over 50 years old remains.

401(k) employee contribution limits have been increased to \$22,500 (up from \$20,500 for 2022) and the catch-up contribution limit for taxpayers above aged 50 has been increased to \$7,500 (up from \$6,500). The total 401(k) contribution for taxpayers age 50 and over will now be \$30,000 for 2023 (\$22,500 regular contribution + \$7,500 catch-up contribution).

SIMPLE IRA contribution limit have been increased to \$15,500 (up from \$14,000)

SEP contribution limits have been increased to \$66,000 (up from \$61,000).

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40

Pass-Through Entity Credit

Several states, including California, have recently enacted legislation that allows S-Corporations and partnerships to pay state income taxes at the business level via their Pass-Through Entity (PTE) tax return - Form 1120S or Form 1065.

This treatment allows state taxes paid at the entity level to be deductible by the shareholder/partner for Federal income tax purposes. This “work-around” was designed to avoid the current \$10,000 limitation on the deductibility of state and local taxes for Federal tax purposes.

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41

Pass-Through Entity Credit

Which states? As of now, following states had either enacted legislation or sent legislation to their governors:

- Alabama • Arizona • Arkansas • California • Colorado
- Connecticut • Idaho • Illinois • Louisiana • Maryland
- Michigan • Minnesota • New Jersey • New York
- North Carolina • Oklahoma • Oregon • Rhode Island
- South Carolina • Wisconsin

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42

Pass-Through Entity Credit

Here is how it works (for California and most states):

- The shareholder/partner will report their share of the corporate or partnership net income to the Internal Revenue Service, but this net will be reduced by the amount of the state tax paid at the entity level. For California, the state tax deducted on the federal return will be added back into net income on the California K-1, but the owners will receive a California tax credit for the tax paid.
- Boiling it down, this allows the K-1 recipient to reduce their federal AGI by the state tax paid, rather than having a state tax deduction on Schedule A. As you know, the state taxes deduction is subject to the \$10,000 state and local tax (SALT) limit.

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43

Pass-Through Entity Credit

Here is how it works (for California and most states):

- This type of SALT workaround has been approved by the IRS (IRS Notice 2020-75).
- California recently passed additional legislation that clarifies the process and makes it favorable for most business owners. The credit limitations have been removed, and those who are allowed to use this process have been expanded.
- Still, before making the election, one must consider current income levels, future business growth, and the timing of the payments that need to be made.

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44

Pass-Through Entity Credit

Questions about the Pass-Through Entity Credit

- What is a Qualified Pass-Through Entity (PTE)?

A qualifying PTE is an entity taxed as a partnership or S corporation. Single member LLCs, in some cases, are now eligible. C Corporations don't qualify.

- Who is a Qualified Taxpayer?

Can be an individual, fiduciary, estate, or trust subject to California personal income tax. They must also be a partner, member, or shareholder of a Qualified PTE.

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45

Pass-Through Entity Credit

Questions about the Pass-Through Entity Credit

- How do you make the election?

An annual election is made on an original, timely filed tax return (California Form 100S, 565 or 568), using Form 3804. Once the election is made, it is irrevocable for that year and is binding on all partners, shareholders, and members of the PTE. An extended tax return will be considered a timely filed return for the purposes of making the election.

- When do you pay the Elective Tax?

For the 2022 taxable year, you must pay the elective tax on or before December 31, 2022. Assumes "down-payment" was made on June 15, 2022.

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46

Pass-Through Entity Credit

Questions about the Pass-Through Entity Credit

- What is the PTE elective tax calculation?

The elective tax is 9.3% of the entity's qualified net income, which is basically the total taxable income subject to California personal income tax. There is no adjusting this percentage.

- When do you get the federal deduction for PTE Tax?

The payment needs to be made on or before December 31, 2022. Because the payment is made in 2022, the federal deduction would be taken on your 2022 tax return.

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47

Pass-Through Entity Credit

Questions about the Pass-Through Entity Credit

- What is included in an entity's qualified net income?

In general, for an S Corporation, this will be the sum of lines 1-10 (all different types of income) minus the sum of lines 11 and 12 (Section 179 and donations) that are on the K-1 (100S). For a partnership, it will be the same, including guaranteed payments made to partners on the K-1 (565/568).

Incidentally, a gain from the sale of an entity level asset (goodwill, for instance) is also included.

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48

Pass-Through Entity Credit

Questions about the Pass-Through Entity Credit

- How does a taxpayer claim his/her tax credit?

Qualified taxpayers are eligible to claim a nonrefundable credit for the amount of tax paid on their portion of the PTE's qualified net income. Unused credits can be carried over for up to 5 years. The credit is claimed on their personal income tax return.

The credit is applied to your taxes before withholding and estimated payments. So, if your PTE credit causes you to overpay your taxes, that amount will be refunded or applied to future years.

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49

Pass-Through Entity Credit

Questions about the Pass-Through Entity Credit

- Can you walk us through a simple calculation?

McFerson Enterprises, Inc. is taxed as an S Corporation, has one shareholder, and has qualified net income of \$200,000 for the year. Using the required 9.3% tax rate, the corporation makes a payment of \$18,600 to the FTB. The corporation then reports \$181,400 (\$200,000 - \$18,600) of net income on the Federal Form 1120s. The California returns filed will report \$200,000 of net income, and a credit of \$18,600 will be available for use against the sole shareholder's individual California income tax.

The shareholder then reports this credit on his/her personal California tax return. Whether this \$18,600 credit can be used in its entirety in the first year depends on the individual taxpayer's personal tax situation. If the credit isn't used in full by year five, then the remaining balance is forfeited.

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50

Cryptocurrency Rules

Effective 2021 tax year

- Virtually all activity now reportable.
- “At any time during 2021, did you receive, sell, exchange or otherwise dispose of any financial interest in any virtual currency?”

1040		Department of the Treasury—Internal Revenue Service (99)		2021	OMB No. 1545-0074	IRS Use Only—Do not write or staple in this space.
U.S. Individual Income Tax Return						
Filing Status <input type="checkbox"/> Single <input type="checkbox"/> Married filing jointly <input type="checkbox"/> Married filing separately (MFS) <input type="checkbox"/> Head of household (HOH) <input type="checkbox"/> Qualifying widow(er) (QW) Check only one box. If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent. ▶						
Your first name and middle initial		Last name		Your social security number		
If joint return, spouse's first name and middle initial		Last name		Spouse's social security number		
Home address (number and street). If you have a P.O. box, see instructions.				Apt. no.		Presidential Election Campaign Check here if you, or your spouse if filing jointly, want \$3 to go to this fund. Checking a box below will not change your tax or refund.
City, town, or post office. If you have a foreign address, also complete spaces below.			State	ZIP code		
Foreign country name		Foreign province/state/county		Foreign postal code		
At any time during 2021, did you receive, sell, exchange, or otherwise dispose of any financial interest in any virtual currency?						<input type="checkbox"/> Yes <input type="checkbox"/> No
Standard Deduction Someone can claim: <input type="checkbox"/> You as a dependent <input type="checkbox"/> Your spouse as a dependent <input type="checkbox"/> Spouse itemizes on a separate return or you were a dual-status alien						

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51

Tax Wish List

What would I like to see changed in the tax law?

- Removal of the SALT limitation. Hampers those that live in high income tax/high property tax states.
- Increase in the mortgage interest deduction limitation. Was \$1.1 million in loan amount. Now \$750k.
- Unreimbursed business expenses – home office/COVID
- Increase in student loan interest deduction
- Elimination of 3.8% Medicare surtax on sale of principal residence

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52

Questions?



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