Tax Impact

Make the most of the general business credit

Gifts that give back

Evaluate the tax benefits of individual and trust charitable donations

Health care expenses: What's deductible?

Tax Tips

Make the most of the general business credit

Tax credits are far more valuable than tax deductions. Unlike a deduction, which reduces a business's taxable income, a credit reduces the business's tax liability dollar for dollar. Tax credits aren't unlimited, however. For businesses, the aggregate value of tax credits may be limited by the general business credit (GBC), found in Internal Revenue Code Section 38. Taxpayers should familiarize themselves with the GBC so they can understand the value of their business credits and identify tax-saving opportunities.

How it works

The GBC isn't a tax credit in the usual sense. Rather, it's a collection of dozens of business-related credits scattered throughout the tax code. (See "What's included in the GBC?" on page 3.) Each credit must be claimed separately, according to its specific rules and using the relevant tax forms. Taxpayers that claim more than one credit, however, must also file Form 3800 to report the aggregate value of those credits and calculate the overall allowable credit under the GBC.

The GBC limits total credits in a given year to the excess (if any) of a taxpayer's net income tax over the *greater* of:

- The tentative alternative minimum tax (AMT) for the year, or
- 25% of the amount by which the taxpayer's net regular tax liability exceeds $25,000.

For purposes of calculating the GBC, "net income tax" is the sum of the taxpayer's regular tax liability and AMT liability, reduced by certain non-GBC credits. "Net regular tax liability" is regular tax liability reduced by certain credits.

The GBC limit essentially prevents taxpayers from using credits to avoid AMT. In recent years, that hasn't been an issue for C corporations, since the Tax Cuts and Jobs Act repealed the corporate AMT. Although the recently enacted Inflation Reduction Act established a new corporate minimum tax for corporations with "book profits" over $1 billion for tax years beginning after December 31, 2022, it generally doesn't limit the GBC. For individual taxpayers — such as sole proprietors, partners and S corporation shareholders — AMT may limit their use of the GBC.

Treatment of unused credits

If the limits prevent a taxpayer from using all of the GBC, the unused credit may be carried back one year and then, if unused credit remains, carried forward up to 20 years. In a given year, the GBC is used in the following order:

- Carryforwards to that year, starting with the oldest ones,
- GBC earned in that year, and
- The carryback to that year.

These ordering rules essentially apply a first-in, first-out (FIFO) approach that minimizes the risk that unused credits will expire. Still, taxpayers with a large surplus of credits may risk losing credits that can't be used within the 20-year carryforward period. Fortunately, the tax code provides some relief for taxpayers in this position.

Deduction for unused credits

To prevent taxpayers from "double-dipping," the tax code generally doesn't permit them to claim a tax credit and a tax deduction based on the same expenses. Thus, in the year that a GBC is generated, taxpayers generally must treat a portion of its expenses (equal to the amount of the credit) as nondeductible.

In many cases, when a credit is lost, Section 196 allows the lost credit amount to be claimed as a deduction. If the credit is lost because the 20-year carryforward period expires, the taxpayer may claim the deduction in the following tax year. If it's lost because the taxpayer dies or ceases to exist, the deduction may be claimed for the year of death or cessation.

The Sec. 196 deduction may provide a tax-saving opportunity for C corporations contemplating a sale. It's common for buyers to acquire a company's stock and then make an election to treat the transaction as a deemed asset sale for tax purposes. But this can trigger substantial taxable gains for the seller. If the seller has significant unused GBCs, it may be able to use a Sec. 196 deduction to offset some or all of those gains (because the selling corporation ceases to exist).

Secure the credits you deserve

Determining GBCs for a given year, and calculating applicable limits, can be complicated. Be sure to work with your tax advisor to make the most of these valuable credits. ■

What's included in the GBC?

A general business credit (GBC) consists of more than 30 individual tax credits that provide incentives for a variety of business activities. Examples include:

- Investment credit,
- Research credit,
- Work opportunity credit,
- Disabled access credit,
- Employer-provided child care facilities and services credit,
- Small employer health insurance credit,
- Credit for small employer pension plan startup costs,
- Employer credit for paid family and medical leave,
- Credit for employer Social Security and Medicare taxes paid on certain employee tips,
- New energy-efficient home credit,
- Alcohol fuels credit,
- Low-income housing credit,
- Empowerment zone employment credit,
- Renewable electricity production credit,
- Orphan drug credit, and
- A portion of the credits for alternative motor vehicles, alternative fuel vehicle refueling property and new qualified plug-in electric drive motor vehicles.

Gifts that give back

Evaluate the tax benefits of individual and trust charitable donations

Congratulations! You've made the decision to donate to your favorite charity. Now you need to decide: Should you donate assets held in a trust or those that you hold individually? There are several factors to consider, such as determining the tax benefits of making individual asset donations vs. donating trust property and understanding the circumstances under which donations by a trust are deductible.

Individual asset donations

Generally, you're permitted to deduct charitable donations for income tax purposes only if you itemize. Itemized charitable deductions for cash gifts to public charities generally are limited to 50% of adjusted gross income (AGI), while cash gifts to private foundations are limited to 30% of AGI. The Tax Cuts and Jobs Act increased the limit for cash gifts to public charities to 60% through 2025.

Noncash donations generally are limited to 30% of AGI for donations to public charities and 20% for donations to private foundations. If you donate appreciated long-term capital gain property to a public charity, you're generally entitled to deduct its full fair market value. But with the exception of publicly traded stock, deductions for similar donations to private foundations are limited to your cost basis in the property. Deductions for ordinary income property (including short-term capital gain property) are limited to your cost basis, regardless of the recipient.

Trust donations

The discussion that follows focuses on nongrantor trusts. Because grantor trusts are essentially ignored for income tax purposes, charitable donations by such trusts are treated as if they were made directly by the grantor, subject to the rules applicable to individual asset donations. Also, this article doesn't discuss trusts that are specifically designed for charitable purposes, such as charitable remainder trusts or charitable lead trusts.

> ***Generally, you're permitted to deduct charitable donations for income tax purposes only if you itemize.***

Making charitable donations from a nongrantor trust may have several advantages over individual donations, including the abilities to 1) claim a charitable deduction even if you don't itemize deductions on your individual income tax return, and 2) deduct donations to foreign charities. And a trust can deduct up to 100% of its gross taxable income, free of the AGI-based percentage limitations previously discussed.

In addition, trust deductions can be more valuable than individual deductions because the highest tax rates for trust income kick in at much lower income levels. For example, in 2022, trusts reach

the highest (37%) tax bracket at only $13,450 of income.

If you're contemplating a charitable donation from a trust, there are a few caveats to keep in mind:

- The trust instrument must authorize charitable donations.
- The donation must be made from (that is, traceable to) the trust's gross taxable income. This includes donations of property acquired with such income, but not property that was contributed to the trust.
- Unlike certain individual charitable donations, deductions for noncash donations by a trust generally are limited to the asset's cost basis.

Special rules apply to trusts that own interests in partnerships or S corporations, as well as to certain older trusts (generally, those created on or before October 9, 1969).

Talk to your advisor

For many individuals, charitable giving is a major aspect of their overall estate plans. Deciding whether to make an individual asset donation or a donation of trust assets can be tricky. If income limits or restrictions on itemized deductions have hampered your ability to deduct charitable donations, consider making donations from a trust. Your estate planning advisor can walk you through the options and help you understand the income and estate tax consequences. ■

Health care expenses: What's deductible?

For many people, unreimbursed medical bills and other health care costs are a significant expense, especially as they get older. Fortunately, many of these expenses are tax-deductible, and some available write-offs may surprise you. To offset the cost of health care, familiarize yourself with the types of expenses that are deductible and be sure to document them with receipts or other records.

Calculating your deduction

If you itemize deductions on your income tax return, you're permitted to deduct a variety of medical and dental expenses for yourself, your spouse and your dependents. But there's a catch: You can deduct them only to the extent the total exceeds 7.5% of your adjusted gross income (AGI). For example, if your AGI is $200,000, you may claim up to $15,000 in medical and dental expenses ($200,000 x 7.5%). So if you have $20,000 in eligible expenses, you may claim a $5,000 deduction ($20,000 – $15,000).

Keep in mind that the deduction is limited to *unreimbursed* expenses. You must reduce your total deductible expenses by any reimbursements from insurance or other sources, regardless of whether you receive the reimbursement directly or it's paid on your behalf to a medical provider.

Identifying eligible expenses

Don't automatically assume that your expenses aren't high enough to generate tax deductions. In addition to traditional doctor and hospital bills and prescription drugs, there are many deductible expenses that are easily overlooked, and the costs can add up quickly.

Examples include payments for:

- Acupuncture and other alternative treatments,
- Inpatient treatment for alcohol or drug addiction,
- Smoking-cessation programs,

- Weight-loss programs for obesity or other physician-diagnosed diseases,
- Admission and transportation to medical conferences (but not meals and lodging) related to a chronic illness of you, a spouse or a dependent,
- Adaptive equipment, such as false teeth, eyeglasses, contact lenses, hearing aids, crutches and wheelchairs,
- Guide dogs,

- Premiums for health insurance or qualified long-term care insurance (other than any portion paid by an employer), and
- Nursing home care, including meals and lodging, if the availability of medical care is the principal reason for being in the nursing home (otherwise, only the cost of medical care is deductible).

If you itemize deductions on your income tax return, you're permitted to deduct a variety of medical and dental expenses for yourself, your spouse and your dependents.

You can also claim transportation expenses essential to obtaining eligible medical care. This may include the cost of a taxi, bus, train or ambulance, as well as personal vehicle costs.

Deducting self-employed health insurance

If you're self-employed, you're entitled to deduct 100% of the health insurance premiums you pay for yourself, your spouse, your dependents and your nondependent children under age 27, regardless of whether you itemize. (The deductible amount may be limited depending on the taxable income of the business.) You can even deduct premiums you pay for Medicare Part B, Medicare Part D or a medigap policy, if you continue to run your business after you qualify for Medicare.

However, there's one important caveat: You can't claim the self-employed health insurance deduction if you're eligible to participate in a subsidized health plan offered by an employer of you or a family member.

If you're self-employed and eligible for the 20% qualified business income (QBI) deduction, also weigh the potential benefits of the self-employed health insurance deduction against any resulting reduction in the QBI deduction. Depending on your particular circumstances, it may be preferable to claim insurance premiums as an itemized deduction to preserve a larger QBI deduction.

Crunching the numbers

Before dismissing the idea that you would benefit from health care expense deductions, contact your tax advisor. Together, you can work through the details and see how your expenses stack up against your AGI. ■

Tax Tips

Should you file a joint return when your spouse dies?

When a spouse dies, the surviving spouse must determine whether to file joint or separate tax returns for that year. Generally, a surviving spouse is permitted, but not required, to file a joint return for the year of death (provided he or she doesn't remarry during the year). Each option has pros and cons, depending on the facts and circumstances. In many cases, a joint return results in a lower overall tax liability by virtue of joint tax rates, larger tax credits for joint filers and tax-planning strategies unavailable to separate filers. For example, the surviving spouse could sell assets that have declined in value to generate losses that can be offset against the deceased's capital gains.

Potential disadvantages of a joint return include exposing the deceased's estate to the surviving spouse's tax liabilities and reducing the value of deductions subject to adjusted gross income (AGI) limits. For example, if the surviving spouse has significant medical expenses, which are deductible to the extent that they exceed 7.5% of AGI, combining the spouse's incomes on a joint return could reduce the value of those deductions. ■

Research credit expanded for small businesses

The Tax Cuts and Jobs Act (TCJA) made it easier for start-up businesses, which often have little or no taxable income, to benefit from research credits. The law permitted start-ups, defined as businesses that are less than five years old and have less than $5 million in gross receipts, to claim research credits against up to $250,000 in Social Security payroll tax liability. The Inflation Reduction Act (IRA) doubles this benefit: For tax years beginning after 2022, eligible businesses may apply up to $250,000 in research credits toward their Social Security payroll tax liability and up to an additional $250,000 toward their Medicare payroll tax liability. ■

Limit on excess business losses extended

The TCJA set a cap on business loss deductions by noncorporate taxpayers. For 2018 through 2025, the TCJA limits deductions for net business losses from sole proprietorships, partnerships and S corporations to $250,000 ($500,000 for joint filers). Losses in excess of those amounts (which are adjusted annually for inflation) may be carried forward to future tax years under the net operating loss rules. Although the CARES Act suspended the limit for the 2018, 2019 and 2020 tax years, it's now back in force and has been extended through 2028 by the IRA. Businesses with significant losses should consult their tax advisors to discuss the impact of this change on their tax planning strategies. ■

This publication is distributed with the understanding that the author, publisher and distributor are not rendering legal, accounting or other professional advice or opinions on specific facts or matters, and, accordingly, assume no liability whatsoever in connection with its use. ©2022