Seven Valuable Tax Credits for Small Businesses

Many people are familiar with tax credits for *individual* taxpayers, such as the credits for higher education expenses or the child tax credit. But *businesses* and business owners also may be eligible for some valuable credits that can lower their tax bills. Here are seven credits for small business owners to consider this tax year and beyond.

1. Research Credit

Even if you don't think of your company as being on the cutting edge of technology, it may qualify for a federal tax credit for research and development expenses. The research credit was extended and modified numerous times in the past before it became permanent in 2015.

In its current form, the credit is generally equal to 20% of the excess of qualified research expenses for the year over a base amount. The term "qualified research expense" is somewhat broadly defined. Typically, these expenses are related to a new or improved function, performance, reliability or quality of a product. The "base amount" for these purposes is a fixed-base percentage (not to exceed 16%) of average annual receipts, net of returns and allowances, for the four years prior to the year of claiming the credit. It can't be less than 50% of the qualified research expenses for the current year. Thus, the minimum credit is equal to 10% of qualified research expenses.

Alternatively, a business may claim a simplified credit equal to 14% of the amount by which its qualified research expenses for the year exceed 50% of its average qualified research expenses for the preceding three tax years.

2. WOTC

The Work Opportunity Tax Credit (WOTC) is another federal tax credit that has expired and been revived multiple times. The latest version was extended through 2020 by the Taxpayer Certainty and Disaster Tax Relief Act, which passed at the end of 2019.

The basic WOTC is available for hiring a worker from one of nine "target" groups. It's generally equal to the worker's first-year wages up to $6,000 if he or she works at least 400 hours during the year, for a maximum credit of $2,400 per worker. For disabled veterans, the credit may be claimed for the first $24,000 of wages, for a maximum credit of $9,600 per worker.

The designated target groups are:

1. Long-term family assistance recipients,
2. Qualified recipients of Temporary Assistance for Needy Families (TANF),
3. Qualified veterans,
4. Qualified ex-felons,
5. Designated community residents who live in empowerment zones or rural renewal counties,
6. Vocational rehabilitation referrals for individuals who suffer from an employment handicap resulting from a physical or mental handicap,
7. Supplemental Nutrition Assistance Program (food stamp) benefits recipients,
8. Supplemental Security Income benefits recipients, and
9. Summer youth employees.

To qualify for the WOTC, a summer youth employee must be 16 or 17 and reside in an empowerment zone or enterprise community. This credit is equal to 40% of the first-year wages of $3,000 earned from May 1 through September 15, up to a maximum of $1,200 for someone working at least 400 hours.

To claim the WOTC, you must be able to show proof from your state's employment security agency that the employee is a member of a targeted group. To do this, you must either: 1) receive the certification from the state agency by the day the individual begins work, or 2) complete IRS Form 8850 on or before the day you offer the individual a job and receive the certification before you claim the credit.

3. Disabled Access Credit

A qualified small business can claim a federal tax credit for making its business premises more accessible to disabled people. For this purpose, in the preceding tax year, qualified small businesses must have:

- Gross receipts of $1 million or less, or
- 30 or fewer full-time employees.

This credit can be carried back for one year and forward for up to 20 years. It equals 50% of the first $10,000 of qualified expenses. (Technically, the first $250 of expenses is excluded, but the credit applies to the first $10,250 of expenses.) Therefore, the maximum credit is $5,000.

To qualify, the expenses must be incurred to meet requirements established by the Americans with Disabilities Act. This includes removing architectural, communication, physical or transportation barriers that prevent a business from being accessible to, or usable by, disabled individuals.

4. Family and Medical Leave Credit

The family and medical leave credit was initially authorized by the Tax Cuts and Jobs Act (TCJA) for 2018 and 2019. It was extended through 2020 by the Taxpayer Certainty and Disaster Tax Relief Act, which was passed at the end of 2019.

The credit is based on wages paid to an employee who's on a family or medical leave. To qualify, the business must provide a leave of at least two weeks (pro-rated for part-time employees) at a rate of at least 50% of regular earnings.

The credit percentage ranges from 12.5% of wages to 25%, depending on the wages paid. If the business chooses to pay the full amount, for example, it can claim the maximum 25% credit.

Important: The tax law doesn't allow "double dipping." In other words, an employer must reduce, by the amount of the credit, the deduction claimed for salary and wages. For instance, suppose the business paid a total of $50,000 in wages for a year in which it claims an FMLA credit of $3,000. The allowable deduction will be reduced to $47,000. Further, wages that are used to qualify for the credit may not also be used to qualify for other wage-based credits, and the business isn't eligible to take the credit against benefits paid to certain highly compensated employees.

5. Retirement Plan Start-Up Credit

Under current tax law, a federal tax credit is allowed for qualified start-up costs incurred by eligible small employers that adopt a new qualified retirement plan like a 401(k), SIMPLE-IRA plan or Simplified Employee Pension (SEP) plan.

The Setting Every Community Up for Retirement Enhancement (SECURE) Act — passed at the end of 2019 — increases the credit available to small business owners who start up a qualified retirement plan for its employees.

Before the SECURE Act, the credit equaled the *lesser* of 1) $500, or 2) 50% of the qualified start-up costs. Under the SECURE Act, for tax years beginning after 2019, the new limit equals the *greater* of:

- $500, or
- The lesser of 1) $5,000, or 2) $250 times the number of non-highly compensated employees who are eligible to participate in the plan.

To qualify, the plan must cover at least one non-highly compensated employee. Qualified start-up costs are expenses connected with the establishment or administration of the plan or retirement-related education for employees with respect to the plan. The credit is available for up to three years, beginning with either: 1) the year the plan is first effective, or 2) the year preceding the first plan year if the employer so elects.

6. Retirement Plan Automatic Enrollment Credit

Employers may encourage employees to participate in 401(k)s and other qualified retirement plans by providing an "automatic enrollment" feature. These plans automatically enroll eligible employees in a plan at a prescribed contribution rate unless the employee affirmatively elects to opt out or make contributions at a different rate.

The SECURE Act creates an added incentive to incorporate this feature into your plan: It establishes a new credit of up to $500 per year to employers who start 401(k) plans or SIMPLE-IRA plans that include an automatic-enrollment feature. The credit can also be claimed by a business converting an existing plan to an automatic-enrollment design. It's available for three years, beginning in 2020. So, you can't claim this credit for the 2019 tax year.

Don't confuse this credit with the enhanced qualified retirement plan start-up credit. An employer can potentially benefit from both tax breaks.

7. Energy Credits

The tax law contains various tax breaks for "going green." Notably, the Taxpayer Certainty and Disaster Tax Relief Act extends tax credits relating to renewable energy and alternative fuels and makes certain other changes to energy tax-related provisions.

Major eco-friendly provisions of the law are:

- A one-year extension of the production tax credit (PTC) for wind facilities if construction begins in 2020 at a 40% reduction of the full PTC,
- A three-year extension for certain PTC-eligible facilities, and
- Extensions of the biodiesel and alternative fuel tax credits.

The legislation also extends a deduction (not a tax credit) for certain energy efficiency improvements to lighting, heating, cooling, ventilation and hot water systems of commercial buildings placed in service before January 1, 2021. A partial deduction may be allowed if certain subsystems meet energy standards but the entire building doesn't meet the standards.

Consult with a Professional

Your small business may qualify for valuable credits — and many other tax breaks — but numerous rules and restrictions apply. Meet with us to discuss these credits and any additional tax-saving opportunities.

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