TaxTips

small business owners summer 2020

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Health Reimbursement Accounts

The choices for employers who offer Health Reimbursement Accounts (HRAs) expanded in 2020. In addition to the traditional HRAs, employers can offer qualified small employer HRAs (QSEHRAs), individual coverage HRAs (ICHRAs) and excepted benefit HRAs (EBHRAs).

An HRA is an employer benefit plan that reimburses employees for out-of-pocket medical expenses. The distributions for qualified medical expenses are tax free for the taxpayer. Qualified medical expenses include health insurance, long-term care insurance, medical expenses not covered by another plan and medicines prescribed to the employee. In a traditional HRA, there is no limitation on how much the employer can set aside for each employee. A traditional HRA can be combined with other employer-provided health benefits.

Small businesses can set up a QSEHRA. There are more benefits, but more requirements. QSEHRAs can be set up by a company with fewer than 50 full-time employees. The company must not offer group health insurance, and all participants must have their own insurance whether from a spouse's employer, a private insurance contract or the Marketplace. Most employees must be eligible for the plan, although there are a number of exceptions. In 2020, the employer must not reimburse more than $5,250 for a single employee, or $10,600 for an employee with family coverage.

New in 2020 is the ICHRA. An ICHRA is available for employers of all sizes. The employer cannot offer a traditional group health insurance plan, and the employee must have their own insurance. It is integrated with employee-held insurance, which can include Marketplace insurance. This type of HRA allows for the reimbursement for health insurance. The annual contribution limit is set by the employer. Employees must be given the ability to opt out if insurance is not affordable, even after the reimbursements. Opting out may lead to the employee being eligible for the premium tax credit.

An EBHRA is not part of a group health plan. Contributions are limited to $1,800 in 2020. Funds cannot be used to reimburse health insurance premiums. An EBHRA can be offered in conjunction with a group health plan. The expenses that can be reimbursed are limited.

Depreciation primer

Depreciation is a complex calculation that represents the wear and tear on property over its useful life. The amount of depreciation depends on the basis, the class life, the method and the convention.

Generally, the basis of property purchased for your business is the cost plus any settlement costs. If you convert property from personal to business use, the basis is the lesser of the fair market value on the date of the conversion or your adjusted basis.

The class life is determined by the type of property that is being depreciated. These class lives range from three-year property, such as tractors and horses, to nonresidential real property with a recovery period of 39 years.

The method generally used is Modified Accelerated Cost Recovery System (MACRS). MACRS has two ways to depreciate: 150% declining balance and 200% declining balance. Property can also be depreciated on the straight-line method, where an equal amount is allowed as depreciation each year over the life of the property.

The default convention is half-year, meaning that the property is considered to be placed into service at the midpoint of the tax year. However, you should depreciate nonresidential real property and residential rental using the mid-month convention. This treats all property placed into service in a month as being placed into service at the midpoint of the month. Finally, you use the mid-quarter convention if mid-month is not required and the value of property you placed in service in the last three months of the tax year exceeds 40% of all property placed in service.

These are the rules for regular depreciation. There are two other types of depreciation: bonus depreciation and §179 expensing.

Certain business property is eligible for **§179 expensing**. To qualify, the property must be acquired for business use by purchase. Generally, the deduction for §179 is the cost of the qualifying property. However, you do not have to elect §179 for the entire cost of the property. The amount that you can deduct is limited to $1,040,000 in 2020. The deduction begins to phase out, dollar-for-dollar, at $2,590,000.

Bonus depreciation can be taken in the first year you place a piece of property into service. You can take 100% bonus depreciation for property acquired after Sept. 27, 2017, and placed into service before Jan. 1, 2023. Eligible property includes tangible property with a class life of 20 years or less as well as other specialized property.

Bonus depreciation is allowed for both new and used property until Dec. 31, 2026. You can elect out of bonus depreciation for each class of property placed into service.

Vehicles

Businesses can deduct vehicle expenses. There are two ways to take expenses: the standard mileage rate or the actual expenses. The **standard mileage rate** for 2020 is 57.5¢ per business mile. **Actual expenses** are the expenses you incur using the vehicle for business purposes. You must choose one or the other, you cannot take both. If you choose the standard mileage rate, you must do so in the year the vehicle is first used for business.

If you take actual expenses, you can depreciate the car. Generally, the car is a capital asset, the deduction for which must be taken over the class life of the asset. Actual expenses include depreciation, lease payments, registration fees, licenses, insurance, repairs, gas, garage rent, tires, oil, parking fees and tolls.

If you elect to take standard mileage, you cannot deduct depreciation, lease payments, maintenance and repairs, gasoline, oil, insurance and registration fees. If you use the car less than 100% for business, you must keep contemporaneous records of your vehicle use.

You may use §179 depreciation to recover some of the cost of a newly purchased vehicle if you use the vehicle for business purposes more than 50% of the time. Depreciation for vehicles is subject to the same limitations as other assets. You may also claim the bonus depreciation for a vehicle. If the vehicle was purchased after Sept. 27, 2017, you can claim up to 100% of the basis of the car. In addition to bonus depreciation, the taxpayer may choose to depreciate the car under one of the methods discussed previously. However, these deductions are limited.

The maximum depreciation deduction for passenger automobiles acquired after Sept. 27, 2017, and placed into service during 2018 or later are shown in the chart below. The depreciation deduction limits for 2020 were not yet released at the time of writing. They are expected to come out this summer.

Date Placed in Service	1st Year	2nd Year	3rd Year	4th Year +
2019	$18,100	$16,100	$9,700	$5,760
2018	$18,000	$16,000	$9,600	$5,760