TRANSPORTATION INDUSTRY

TAX PLANNING IDEAS FOR THE NEW YEAR: PART ONE

OTA OHIO TRUCKING ASSOCIATION

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TAX PLANNING IDEAS FOR THE NEW YEAR FOR THE TRANSPORTATION INDUSTRY

We discuss many different tax planning ideas with our transportation company clients in the last quarter of each year but there are many tax planning opportunities that are available year round. Some of these planning ideas can even be accomplished after the end of the year. This whitepaper is the first in a two part series the will recap many ideas that your trucking company can implement now for either 2023 or 2024.

Research and Development R&D Tax Credit for the Transportation Industry

Innovation, research, experimentation, evolution. Many on the outside of the trucking industry would not think to associate these words with such a long-standing industry, but they would be wrong. In today's world, technology is intrinsic in every industry including trucking and logistics. Technologies including automation, efficiency, data analysis, and the internet-of-things have spawned new solutions that are necessary for companies to remain competitive and profitable in an ever-changing market.

Expansion of new and improved technology is occurring throughout the industry with significant financial investment. To fully achieve competitive advantages many companies are not stopping at implementing off-the-shelf solutions but undertaking customization efforts or full development of home-grown solutions that provide features and functionalities not current available in the marketplace. While focused on this innovation, many organizations are overlooking a powerful incentive that can provide tax savings to offset spending on new and improved technology – the Research and Development ("R&D") Tax Credit.

What is the R&D Tax Credit?

The R&D Tax Credit, formally known as the Credit for Increasing Research Activities, was first enacted in 1981 as part of the Economic Recovery and Tax Act with the goal of incentivizing innovation and the retention of top talent in the US. This was a temporary measure, re-enacted for decades until it was finally made permanent with the passing of the Protecting Americans from Tax Hikes Act in 2015. Although the name of the credit sounds like something that should be reserved for scientists wearing white lab coats and safety glasses, taxpayers from all industries may be eligible if they meet the following requirements:

1. Permitted Purpose: The activity must be related to the development or improvement of the function, performance, reliability, or quality of a qualified business component – product, process, technique, formula, invention, or computer software.
2. Technical in Nature: The activity must fundamentally rely upon principles of "hard sciences" to qualify. Examples include engineering, physics, or computer science.
3. Elimination of Uncertainty: The activity must be intended to eliminate technical uncertainty related to the design, capability, or methodology of developing a new or improved business component.
4. Process of Experimentation: Substantial activity must contain elements of a process of experimentation in which one or more alternatives are evaluated to eliminate the technical uncertainty.

If a taxpayer is conducting activities that meet the criteria, then certain expenses for those activities can be used to calculate an R&D tax credit. The primary expenses that can be qualified for the R&D credit are wages, contract research, and cloud hosting expenses.

How does the R&D Tax Credit apply to the transportation and logistics industry?

The R&D tax credit can be applied to a myriad of industries, including the transportation and logistics industry, that might not seem obvious at first. The criteria are not meant to describe specific qualifying activities and must be applied to each unique scenario to determine if those activities are eligible for the R&D tax credit.

Potentially qualifying activities related to the transportation and logistics industry include, but are not limited to, the following:

- Developing prototypes or models to improve functionality, performance, reliability, or quality
- Developing custom or first-in-kind equipment
- Developing custom hardware for increased monitoring or improved fuel efficiency
- Customizing off-the-shelf software solutions to meet your organizations unique requirements
- Developing new software solutions for fleet management, dynamic routing, or e-payments
- Developing mobile applications
- Developing autonomous technology to improve safety and efficiency

How do R&D activities translate into tax credits?

If you recognize some of the activities outlined above when you think about your business, you're probably wondering how to get from a qualifying activity to money in your pocket. Typically, the biggest R&D expense for transportation and logistics companies is employee wages. More specifically, it's the investment of your employees' time in developing a new or improved design, process, or computer software. Qualified wages are quantified by determining who is conducting qualified activities, how much time those individuals are spending on those activities, and how much that time is valued according to their wages.

Another common expense is third party contractor costs. These can be related to a variety of services, including software design and development, testing, or outsourcing of design or engineering services.

Once you have qualified costs for qualified activities, you can use those expenses to calculate the R&D Tax Credit. In addition to the Federal credit, many states, including Ohio and Pennsylvania offer state R&D tax credits.

Generally, the Federal R&D Tax Credit represents a more robust tax savings compared to state credits, and functions as a dollar-for-dollar reduction of a taxpayer's payroll and/or income tax liability. It's important to note that, because the R&D Tax Credit was created to incentivize continued investment into research and development, the mechanics of the credit calculation benefit companies that are increasing their research activities and expenses year over year. For those businesses that are increasing their investment in R&D each year, they can expect approximately 5% to 11% of their qualified expenses to be returned in the form of a credit. Therefore, a taxpayer spending $1MM on qualified research expenditures could receive a credit equaling $50,000 to $110,000. The bigger the increase in spend over prior years, the close you get to the upper end of the potential credit range.

Help Boost Cash Flow with a Tax Accounting Method Change

2023 might be in the rear-view mirror, but it's not too late to evaluate your businesses tax accounting methods and whether an accounting method change could still save your business money on your 2023 tax return filings.

As transportation companies turn the page on 2023 and move into 2024, continued dialogue on accounting methods are important. That said, you might be scratching your head and asking, "what is an accounting method?"

Well, an accounting method is a set of rules and procedures for reporting revenues and expenses in a company's financials. And an accounting method determines when to recognize items of income or expense in taxable income. So therefore, a business can have an acceptable accounting method for financial reporting purposes and have another, acceptable IRS approved accounting method for reporting income on their tax returns.

As of last year, the IRS had 250+ different acceptable accounting method changes (yes, 250!); however, in this article we will focus on one that we see has the broadest application and generally, the largest tax savings – electing the overall cash method of accounting instead of the accrual method.

Tax reporting on the overall cash method of accounting

While most businesses with less than $29 million combined gross receipts can generally adopt the cash method of accounting automatically for tax purposes, there is a special provision for transportation companies with less than $50 million in combined gross receipts that allows that business to automatically adopt the cash method. Adoption of the cash method of accounting means that a business is taxed on revenue when cash is collected, and expenses are deducted when paid. Whereas under normal accrual accounting, a business is taxed on income when it is earned or when expenses are due – even if cash has not been collected or expenses actually paid. So if the transportation company has higher customer receivables than vendor payables and accruals, overall income would be deferred into the future, resulting in a lower tax obligation today and aligning a business tax obligations with the cash collections. This cash method provides a more accurate reflection of actual cash flow and can be particularly beneficial in the transportation industry where cash flow is essential for fuel, maintenance, equipment and other immediate, capital-intensive expenses. So improved cash flow management is just one advantage to being on the cash method of accounting.

Other advantages include tax planning flexibility and simplicity. Businesses can time cash payments of expenses and deploy cash to pay down vendors, owner-operators, bonuses, payroll, or other equipment purchases to optimize their taxable income in a given year. Also, the cash method can be simpler and more straightforward than the accrual method. It records transactions when cash changes hands, making it easier for smaller businesses with limited accounting resources.

In addition to a cash method of accounting change, other tax accounting methods that should be considered for transportations companies include:

- Depreciation methods – reviewing historical fixed asset listings to ensure proper depreciable lives were used could result in finding that more of your capital expenditures could have been expensed sooner.
- Accounting for fuel tax credits and usage of alternative fuels
- Accounting for per diem expenses
- Accounting for research and development expenditures

Hopefully this highlighted that it is essential for transportation businesses to work closely with tax professionals who specialize in the industry to navigate complex regulations and maximize available tax benefits. While this article covered the automatic cash method of accounting change rules, it should be noted that transportation companies that have more than $50 million in combined gross receipts could still be eligible to adopt the cash method of accounting for tax reporting purposes. These larger taxpayers will need to follow a different set of procedures. As tax laws continually change and business circumstances continually change, staying informed and seeking professional advice is crucial for making well-informed decisions.

The End of an Era: Expiring Tax Law

The Tax Cuts and Jobs Act (TCJA) of 2017 made many changes for taxpayers. Some of these changes are set to expire over the coming years. The recap below is the law as it stands today. As we go to press, there is a proposal agreed to by the House and Senate tax writing committees that may extend these expiring provisions. One of the larger changes is the ability to immediately expense qualified business property.

Since September 27, 2017, taxpayers have been able to claim additional first-year depreciation on certain new and used qualifying property placed in service. This has been a great way to reduce a taxpayer's overall liability. This amount has been 100% of the cost of property, however starting on January 1, 2023, this bonus expense gets reduced at a rate of 20% per year:

Bonus Depreciation

- 100% for property placed in service after September 27, 2017 and before January 1, 2023
- 80% for property placed in service in 2023
- 60% for property placed in service in 2024
- 40% for property placed in service in 2025
- 20% for property placed in service in 2026
- 0% for property placed in service after December 31, 2026

The remaining cost after the additional depreciation (for example: 20% in 2023) is not lost but depreciated over the useful life of the asset. The life can depend on the underlying asset, for trucking companies this life is 5 years for trailers and 3 years for a separate tractor unit. With bonus depreciation phasing out there is another opportunity to expense property under Section 179. This deduction depends more on the taxpayers situation and should be evaluated under certain circumstances.

Qualified Business Income Deduction

New to both taxpayers and tax professionals in 2018 was a qualified business income (QBI) deduction that allows individuals to deduct up to 20% of their qualified business income. Under current law this is set to go away after December 31, 2025. The QBI deduction was enacted to help owners of passthrough entities and self-employed individuals reduce their effective tax rate on business income when compared the lower corporate flat tax rate of 21% with TCJA. However, unlike QBI, the 21% corporate tax rate was made permanent and will not reverse to pre TCJA rates.

Meal Deductions and Per Diems

For tax years 2021 and 2022 motor carriers with drivers that are subject to the hours-of-service could deduct 100% of the meals portion of the per diem expense. After 2022 this deduction goes back to 80% of the per diem expense. This treatment is favorable as compare to the business meals for other industries only being 50% deductible.

A tool for trucking companies to retain drivers is to put a per diem arrangement in place for overnight travel. As of October 1, 2023, the per diem rate for the transportation industry is $69 for continental US and $74 for travel outside the continental US.

As these tax provisions come to an end it is important to be in the know and tax plan over the coming years. We will continue to monitor any developments related to these expiring provisions in the future.

Learn more about our R&D Tax Credits services at **www.schneiderdowns.com/research-development-tax-credits** or contact the team at **contactsd@schneiderdowns.com**.

Ohio Trucking Association

The Ohio Trucking Association is a 100-year-old full-service trade association operating in Columbus, Ohio. With over 815 total members in the trucking, logistics, warehousing and moving industries, our promise to our members is simple: the Ohio Trucking Association will work to improve operational efficiency, profitability and relevancy for all of Ohio's transportation industry. Advocacy, professional development, networking and cost savings initiatives are the keys to carrying out this promise to our members. No matter what the cause, our industry is stronger when operating as one. We encourage you to explore more about becoming involved with the Ohio Trucking Association at **www.joinota.com**.

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Schneider Downs Transportation and Logistics Industry Group

Established in 1956, Schneider Downs has grown to be one of the largest independent public accounting and advisory firms in Columbus, Ohio; Western Pennsylvania and Metropolitan Washington, with over 500 personnel in total, including 57 shareholders and partners.

More than 25 years ago, we established the Schneider Downs Transportation and Logistics Industry Group. The group includes assurance, tax, technology and management consulting professionals who combine their individual expertise to serve our wide range of transportation and logistics clients—from local carriers to national enterprises, including: trucking, general freight, flatbed and box, TL, LTL, tank waste brokerage, bulk commodity dump, 3PL, heavy hauling/ permitted loads, moving and warehousing. The Transportation and Logistics Industry Group meets on a regular basis to review and analyze issues central to this industry. As a result, our transportation and logistics professionals possess the most current knowledge of transportation issues, regulations and trends. We work with you to seek innovative ways to reach your strategic goals.

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