



Year End Tax Planning for Businesses

December 2015

To Our Clients and Friends:

Businesses seeking to maximize tax benefits through 2015 year-end tax planning may want to consider several general strategies, such as use of traditional timing techniques for income and deductions and the role of the tax extenders (if renewed and in the event they are not renewed), as well as strategies targeted to their particular business. As in past years, planning is uncertain because of the expiration of many popular but temporary tax breaks (including bonus depreciation and the increased Code Section 179 expense deduction limit). Also added to the mix are the far-reaching implications of the Affordable Care Act (ACA).

AFFORDABLE CARE ACT

Businesses large and small continue to work to comply with the ACA. For large businesses (generally known as applicable large employers or ALEs), the ACA imposes a number of new requirements, including the employer shared responsibility provision (also known as the employer mandate). Small businesses, although generally exempt from the employer mandate, need to review how they deliver health insurance (if offered) to their employees.

Many small businesses have traditionally provided a health benefit to their employees through a health reimbursement arrangement (HRA). Following passage of the ACA, the IRS described certain types of HRAs as employer payment plans. Therefore, they are considered to be group health plans subject to the ACA's market reforms, including the prohibition on annual limits for essential health benefits and the requirement to provide certain preventive care without cost sharing. Failure to comply with the ACA's market reforms triggers excise tax of \$100 for each day you are noncompliant. This announcement by the IRS has left many small businesses uncertain how to proceed. There is pending legislation in Congress that would allow small employers (employers with less than 50 full-time and full-time equivalent employees) to have stand-alone HRAs and reimburse expenses without violating the ACA's market reforms. Our office will keep you posted of developments.

Reporting requirements. Under the Affordable Care Act, applicable large employers (those with 50 or more full-time employees, including fulltime equivalent employees), and providers of self-insured health plans are required to take new actions. These employers must file information returns with the IRS and also provide statements to full-time employees about health coverage the employer offered or to show the employer didn't offer coverage.

Information reporting was voluntary for calendar year 2014. All applicable large employers are required to report health coverage information for the first time in early 2016 for calendar year 2015. If paper filed, Forms 1095-B and 1095-C must be filed with the IRS by February 28th of the year following the calendar year in which minimum essential coverage is provided. If filing electronically, the due date is extended to March 31st. Employers must provide a copy of the 1095-C to their employees by February 1, 2016. **This**

means the initial due date for ACA reporting is February 1, 2016. Please contact us to discuss your potential ACA filing requirements.

REPAIR-CAPITALIZATION RULES

In 2013 the IRS issued long-awaited comprehensive final rules on the treatment of payments to acquire, produce or improve tangible property. Businesses are now required to use these new rules in determining whether they can deduct their costs as repairs under Code Sec. 162(a) or must capitalize the costs, to be recovered over a period of years under Code Sec. 263(a).

The regulations provide a number of taxpayer friendly provisions, including the de minimis safe harbor threshold amount under the final "repair regs" for taxpayers. Currently, a de minimis safe harbor under the repair regs allows taxpayers to deduct certain items costing \$5,000 or less (per item or invoice) and that are deductible in accordance with the company's accounting policy reflected on their applicable financial statement (AFS). An AFS is generally an audited financial statement. The IRS regulations also provide a \$500 de minimis safe harbor threshold for taxpayers without an AFS. This \$500 threshold for businesses without an AFS is increasing to \$2,500 for tax years beginning on or after January 1, 2016.

Other beneficial provisions include the safe harbor for routine maintenance, the small taxpayer safe harbor for repairs and improvements to real property, and the deduction for a partial asset disposition.

SAME-SEX MARRIAGES

The IRS issued guidance stating that same-sex couples who are legally married in jurisdictions that recognize their marriages will be treated as married for federal tax purposes regardless of whether or not their current place of residence recognizes same-sex marriage.

IRS guidance further explains that a cafeteria plan may treat a participant who was married to a same-sex spouse as of the date of the Windsor decision (June 26, 2013) as if the participant experienced a change in legal marital status. Accordingly, a cafeteria plan may permit such a participant to revoke an existing election and make a new election in a manner consistent with the change in legal marital status. A cafeteria plan may also permit a participant who marries a same-sex spouse after June 26, 2013, to make a mid-year election change due to a change in legal marital status. Plan amendments may be necessary to comply with the new rules.

For details on provisions, permissions, reimbursements and other implications of a cafeteria plan through a participant's flexible spending account (FSA), including a health, dependent care, or adoption assistance FSA, please contact us.

BONUS DEPRECIATION AND CODE SEC. 179 EXPENSE DEDUCTION

Many businesses have utilized enhanced Code Sec. 179 expensing as a key component of year-end tax planning. Both bonus depreciation and the increases in the Code Sec. 179 expense deduction and investment limits were meant to provide temporary incentives for business investment and expired at the end of 2014. Unless there is further legislative action, the Code Sec. 179 deduction limit is set at \$25,000, and the investment limitation is set at \$200,000 for tax years beginning in 2015. We will keep you apprised of any future legislation impacting this.

Code Sec. 179 property is generally defined as new or used depreciable tangible Code Sec. 1245 property that is purchased for use in the active conduct of a trade or business. In 2014, off-the-shelf computer software was also included as was qualified real property (qualified leasehold improvement property,

qualified restaurant property, and qualified retail improvement property). At the time this letter was prepared, the enhancements to Code Sec. 179 expensing had not been renewed by Congress for 2015 but the likelihood is very high that they will be renewed. Year-end planning should reflect both the likely extension, and the possibility of no extension.

Similarly, bonus depreciation has been a valuable incentive for many businesses. Fifty percent bonus depreciation generally expired after 2014 (with limited exceptions for certain types of property). Qualified property for bonus depreciation purposes must be depreciable under the Modified Accelerated Cost Recovery System (MACRS) and have a recovery period of 20 years or less. These requirements encompass a wide variety of assets. Year-end placed-in-service strategies therefore can provide an almost immediate “cash discount” for qualifying purchases. Although a bonus-depreciation election should be factored into a year-end strategy, a final decision on making it is not required until a return is filed. Further, bonus depreciation is not mandatory. Certain taxpayers should consider electing out of bonus depreciation to spread depreciation deductions more evenly over future years.

Returning to Code Sec. 179 expensing, one potentially useful strategy is to maximize benefits under Code Sec. 179 by expensing property that does not qualify for bonus depreciation (such as used property) and property with a long MACRS depreciation period. For example, given the choice between expensing an item of MACRS five-year property and an item of MACRS 15-year property, the 15-year property should generally be expensed since it takes 10 additional tax years to recover its cost through annual depreciation deductions as opposed to recovery of the cost of the five-year property.

TAX CREDITS

Absent legislation, each of the following tax credits will not be available for the 2015 tax year. These tax provisions would likely be included in extenders legislation for 2015 and beyond.

- **Research Credit.** The research credit is claimed for increases in qualified research expenditures and for increased payments to others, such as universities, for basic research.
- **Work Opportunity Credit.** The work opportunity credit for all targeted groups is extended through December 31, 2014. Therefore, the credit applies with respect to wages paid to persons who begin work for the employer before January 1, 2015.
- **Differential Wage Credit for Activated Military Reservists.** Eligible small employers can claim a tax credit for up to 20% of the military differential wage payments it makes to activated military reservists through December 31, 2014.

RECOGNITION PERIOD FOR S CORPORATION BUILT-IN GAINS

For tax years beginning in 2014, for purposes of computing the built-in gains tax, the recognition period is the five years beginning with the first day of the first tax year in which the corporation was an S corporation. Absent legislation, the recognition period for tax years will be ten years beginning in 2015.

IDEAS FOR YOUR BUSINESS

Get a Tax Credit for Paying Health Insurance Premiums. Small employers with no more than 25 full-time equivalent employees may qualify for a special tax credit to help offset the cost of health insurance for their employees. The employer must pay average annual wages of no more than \$50,000 per employee

(indexed for inflation) and maintain a qualifying health care insurance arrangement. Generally, health insurance for employees must be obtained through the Small Business Health Options Program (SHOP), which is part of the Health Insurance Marketplace.

Get a Cost Segregation Study to Accelerate Deductions. Cost segregation is a highly beneficial and widely accepted tax planning strategy utilized by real estate owners and tenants to accelerate depreciation deductions, defer tax, and improve cash flow. A cost segregation study is based on a detailed engineering analysis that is used to support the acceleration of depreciation deductions by identifying costs that can be allocated to shorter recovery periods: primarily 5, 7 and 15-year, as opposed to 27.5 (residential rental) or 39-year (commercial).

There are a number of benefits associated with cost segregation and its various applications. The primary benefit is significantly improved cash flow. This is most often achieved through the acceleration of depreciation deductions and the resulting tax deferral. Commercial or residential rental property, of any size, placed in-service after December 31, 1986 may qualify for a cost segregation study.

Your Expenses May Qualify for the Domestic Production Activities Deduction. This deduction is available to companies involved in domestic manufacturing, construction, engineering or architectural services related to construction projects, and other eligible production activities. For 2015, the deduction is 9% of the lesser of: (1) qualified production activities income or (2) taxable income before taking the deduction into account. However, the deduction can't exceed 50% of W-2 wages allocable to domestic production gross receipts. If your company is eligible, the deduction could cut your taxes and increase your after-tax profits without any additional outlay.

Evaluate Your Business Entity Structure. The structure of your business - C Corporation, S Corporation, Partnership, Limited Liability Company (LLC), or Sole Proprietorship - determines how your business income is taxed. A C Corporation pays tax on its income at corporate tax rates. Generally, the income, losses, deductions and credits of an S Corporation, Partnership, or LLC are passed through to the owners to be reported on their tax returns. Sole proprietors also report business income and deductions on their tax returns.

The "single layer" of taxation offered by S Corporations, Partnerships and LLCs has been beneficial for many taxpayers. Starting in 2013, these owners (as higher income taxpayers) faced new year-end planning challenges in the form of a higher individual tax rate of 39.6% and additional surtaxes on passive income by way of the net investment income surtax of 3.8% plus the Additional Medicare Tax of 0.9% on compensation. Faced with these individual income tax rate increases, it may help businesses to be taxed as a C Corporation.

Business tax planning involves, not only economic planning for that year, but also making wise tax decisions that will benefit the business for years to come. Tax-saving strategies must take into account short-term and long-term goals so that decisions made for the current tax year also represent sound tax decisions in following years. Often, because business planning opportunities must be viewed in conjunction with personal tax planning, a taxpayer should also consider planning tips affecting their individual return and investment considerations when making business decisions.

Discuss Options for Recognizing Cancellation of Debt (COD) Income. The discharge of indebtedness must be included in a taxpayer's gross income. There are exceptions to this rule, so a careful examination of a business' COD income is important to determine any potential tax consequences. For

example, insolvent taxpayers are able to exclude COD income to the extent that they are insolvent. The COD rules are extremely complex and specific situations need to be carefully analyzed to determine the proper plan.

Consider Qualified Retirement Plan Options. Offering your employees a variety of benefits, including the opportunity to participate in a qualified retirement plan can help you attract and retain the best employees. To receive a benefit in 2015, some plans must be established by the end of the year. There are a number of plan options to consider. HBK can help you decide which option is best for your business.

ENVIRONMENTALLY FRIENDLY IDEAS

Take Advantage of the Business Energy Credit. Businesses can receive a tax credit of up to 30% of the cost of qualified energy property placed in-service during a tax year. Qualified energy property includes solar property, geothermal property, qualified fuel cell or microturbine property, combined heat and power systems property, qualified small wind energy property, and geothermal heat pump systems. There are also various related grants available for purchasing or constructing qualified energy property.

Get a Tax Deduction for Energy Efficient Commercial Buildings. A tax deduction of up to \$1.80 per square foot is available to owners or designers of new or existing commercial buildings that save at least 50% of the heating and cooling energy of a building that meets ASHRAE Standard 90.1-2001. Partial deductions of up to \$.60 per square foot can be taken for measures affecting any one of three building systems: the building envelope, lighting, or heating and cooling systems. Professional certification is required to determine if your new building or building improvements meet the necessary deduction qualifications. This deduction is not currently eligible for property placed in service after 2014.

CONCLUSION

Many taxpayers are wondering how they may be able to prepare for 2015 and beyond, and what to do before then. The short answer is to become familiar quickly with the expiring tax incentives and what may replace them after 2015, and to plan accordingly. We can help you align traditional year-end techniques with strategies for dealing with uncertainties created by Congress's delay in addressing the extension of major tax benefits.

With careful planning, it is possible that your 2015 and 2016 tax liability can still be reduced. We need to assess your position carefully to determine how best to maximize your tax savings for 2015 and beyond. We are available to assist you in this planning process any way we can and again, we will keep you apprised of any legislative changes impacting your tax scenario in real time. Please don't hesitate to contact us with questions, concerns or ideas you have with regard to reducing your taxes. Never doubt that we're here to help.