HBK CPAs & Consultants

December 2016

To Our Clients and Friends:

As 2016 winds down, business owners may still benefit from several tax savings strategies. At HBK CPAs & Consultants, we want to ensure that our clients and colleagues are aware of the many opportunities still available and applicable even at this late date in the year.

Year-end planning for 2016 is complicated by impending changes to 2017 (and future years) the new Congress and Administration may make to the Tax Code. President elect Trump made tax reduction a centerpiece of his economic plans during his campaign, by, among other things, proposing lower and consolidated individual income tax rates, expanded tax breaks for families, and the intent to repeal the Affordable Care Act. Specifically, he proposed lowering the corporate income tax rate to 15 percent, taxing pass-through entities (sole proprietorships, partnerships, and S Corporations) at a flat rate of 15 percent for income retained in the business, and increasing the annual cap on Code Sec. 179 expensing from $500,000 to $1 million. Campaign materials also state unspecified business tax incentives would be eliminated.

Businesses seeking to maximize tax benefits through 2016 year-end tax planning should also look ahead and consider the potential impact of changes to the tax code to their businesses. If these proposals become law your tax planning needs to be reviewed. We will work with you to maximize your businesses potential tax savings.

TAX LEGISLATION

In 2015, Congress passed the Protecting Americans from Tax Hikes (PATH) Act which permanently extended many tax incentives that were previously temporary. However, other provisions were not extended past 2016. The following is a summary of some of the more common business provisions.

Bonus depreciation and Code Sec. 179 expense deduction. Many businesses utilize 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 were set to expire at the end of 2014. The PATH Act permanently extended the $500,000 per year Sec. 179 limitation and dollar-for-dollar phase out for businesses with qualifying equipment purchases exceeding $2 million. Starting in 2016, the annual Sec. 179 limitation will be adjusted for inflation. The Act also extended bonus depreciation at 50% for qualifying equipment placed in service through 2017. Bonus depreciation will phase down to 40% in 2018, and 30% in 2019.

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. Off-the-shelf computer software and qualified real property (qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property) are also eligible for Sec. 179 expensing.

Generally, property qualifying for bonus depreciation is new or original use tangible personal property. Certain real property falling within the definition of qualified leasehold improvement property was also eligible for bonus depreciation through the end of 2015.

Beginning in 2016, the PATH Act replaced the bonus depreciation allowance for qualified leasehold improvement property with a bonus allowance for a new class of property, qualified improvement property. Qualified improvement property is any improvement to an interior portion of a building that is nonresidential real property if the improvement is placed in service after the date the building was first placed in service.

Qualified improvement property does not include any expenditure attributable to enlarging the building, any elevator or escalator, or the internal structural framework of the building. This new class of bonus property also does not include the pre-2016 requirements that the expenditure be made pursuant to a lease, or be placed in service more than three years after the date the building was first placed in service.

Year-end placed-in-service strategies can provide an almost immediate tax 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. Bonus depreciation is not mandatory. Certain taxpayers should consider electing out of bonus depreciation to spread depreciation deductions more evenly over future years.

Tax credits. The following tax credits scheduled to expire at the end of 2014, were extended by the PATH Act.

- ***Research Credit.*** The research credit is claimed for increases in qualified research expenditures. The Research Credit was permanently extended by the PATH Act. The Act also allows the eligible small businesses (generally those with no more than $50 million in gross receipts) to offset both regular tax and AMT with research credits. Start-up small businesses can now elect to apply a portion of the research credit against payroll tax instead of income tax. These positive changes to the research credit can have significant benefits for many taxpayers.
- ***Work Opportunity Credit.*** The work opportunity credit for all targeted groups is extended through December 31, 2019.
- ***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. The differential wage credit for activated military reservists was permanently extended by the PATH Act.

Recognition period for S Corporation built-in gains. The PATH Act permanently extends the shortened S Corporation built-in gains holding period. 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.

REVISED DEADLINES

The due date for filing partnership and C corporation returns was modified by the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015. Generally applicable to returns for tax years beginning after December 31, 2015, both Forms 1120-S and 1065 are due on or before the 15th day of the third month following the close of the tax year (March 15 for calendar-year taxpayers). The due date for the filing of Form 1120 by C corporations is changed to the 15th day of the fourth month following the close of the tax year (April 15 for calendar-year taxpayers).

Many taxpayers and tax professionals have long advocated for these changes to return due dates. These staggered due dates were recommended not only to enable taxpayers to receive Schedule K-1 information in time to meet their initial filing deadlines. They also help even out the workflow faced by tax preparers both in dealing with initial deadlines and with extensions. Further, the revisions are expected to contribute to a reduction in the need for extended and amended individual income tax returns.

AFFORDABLE CARE ACT

Despite several delays and legislative tweaks, the basic structure of the ACA for businesses, both large and small, generally remains intact. If an employer is an applicable large employer (ALE), this triggers employer shared responsibility provisions and the employer information reporting provisions. Small businesses, too, are affected by the ACA and should take the ACA into account in year-end planning. Some incentives under the ACA, including health reimbursement arrangements and small business health care tax credits, can help maximize tax savings for small businesses. Information reporting under the ACA continues to challenge all businesses. We 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.

All applicable large employers were **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 March 2, 2017. **Please contact us to discuss your potential ACA filing requirements. We can assist your business with the preparation and filing of these forms.**

REPAIR-CAPITALIZATION RULES

The now three-year old final regulations on the treatment of payments to acquire, produce or improve tangible property still provide the potential for tax saving. Businesses are 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 $2,500 de minimis safe harbor threshold for taxpayers without an AFS. This $2,500 threshold for businesses without an AFS was increased from $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.

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 2016, 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.

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 2016, 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. This deduction is not currently eligible for property placed in service after 2016.

CONCLUSION

The importance of year-end tax planning for 2016 has been heightened by the potential for a reduction in future tax rates. It is possible your 2016 and 2017 tax liability can still be reduced through careful planning. At HBK, we can determine how best to maximize your tax savings for 2016 and beyond. We are available to assist you through each step of this process and we will keep you apprised of any legislative changes impacting your tax circumstance in real time. Please don't hesitate to contact us with questions, concerns or ideas you about how to reduce your taxes.