Re: 2016 Year-End Tax Planning for Businesses

Dear Client:

Businesses seeking to maximize tax benefits through 2016 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. Also added to the mix is the far-reaching Affordable Care Act (ACA).

Expensing and Bonus Depreciation

Many businesses have utilized enhanced Code Sec. 179 expensing as a key component of year-end tax planning. 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 2015, 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 2016 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 2015 (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.

Code Sec. 199 Deduction

Year-end planning benefits from the release of guidance on the Code Sec. 199 domestic production activities deduction. The Code Sec. 199 deduction, in comparison to some other business incentives, has been under-utilized. The guidance provides many examples of what business activities qualify

for the deduction. Recent IRS guidance highlights manufacturing, construction, oil related work, film production, agriculture, and many other activities. Our office can help you ascertain if your business activity may qualify for this potentially valuable incentive.

Work Opportunity Tax Credit

Businesses considering expanding their payrolls before year-end 2016 should take a look at the Work Opportunity Tax Credit (WOTC). Although the WOTC, under current law, expired after 2015, the expectation is that Congress will renew the WOTC for 2016 (and possibly for 2017). Generally, the WOTC rewards employers that hire individuals from targeted groups, including veterans, families receiving certain government benefits, and individuals who receive supplemental Social Security Income or long-term family assistance. The WOTC is generally equal to 40 percent of the qualified worker's first-year wages up to $6,000 ($3,000 for summer youths and $12,000, $14,000, or $24,000 for certain qualified veterans). For long-term family aid recipients, the credit is equal to 40 percent of the first $10,000 in qualified first year wages and 50 percent of the first $10,000 of qualified second-year wages.

Repair-capitalization rules

Another valuable incentive for year-end planning is 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). IRS regulations also provide a $500 de minimis safe harbor threshold for taxpayers without an applicable financial statement.

Routine service contracts

Accrual basis taxpayers also have a new tool to use in year-end planning. The IRS has provided a safe harbor under which accrual-basis taxpayers may treat economic performance as occurring on a ratable basis for ratable service contracts. The IRS also indicated that additional safe harbors may be developed. This new safe harbor may be particularly useful in connection with regular services that extend into 2017. Taxpayers meeting the safe harbor for ratable service contracts may take a full deduction in the current 2016 tax year for certain 2016 payments, even though services may not be performed until 2017.

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 employers.

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 taxes under Code Sec. 4980D. 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.

Small employers also should review the Code Sec. 45R credit. 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.

These are just some of the considerations that make up year-end tax planning for businesses. Please contact our office so we can discuss your 2016 year-end business tax planning in detail.

Sincerely yours,

Paul S Mann CPA