

SDDCO 2016 Year-End Tax Planning Guide for Businesses

Contact SDDCO for help in implementing these or other year-end Tax strategies that might be suitable to your particular situation.

Tax Planning for Businesses

There is still time to reduce your 2016 tax bill and plan ahead for 2017. This letter highlights potential tax-saving opportunities for business owners. I am available to discuss any specific planning opportunities and issues you might have in mind.

■ Deferring Income into 2017

Deferring income to the next taxable year is a time-honored year-end planning tool. If you expect your taxable income to be higher in 2016 than in 2017, or if you anticipate being in the same or a higher tax bracket in 2016 than in 2017, you may benefit by deferring income into 2017. Of course, if an individual is subject to the alternative minimum tax, standard tax planning may not be warranted. Some ways to defer income include:

Use of Cash Method of Accounting: By adopting the cash method of accounting instead of the accrual method, you can generally put yourself in a better position for accelerating deductions and deferring income. There is still time to implement this planning idea, because an automatic change to the cash method can be made by the due date of the return including extensions. The following three types of businesses can make an automatic change to the cash method: (1) small businesses with average annual gross

receipts of \$1 million or less (even those with inventories that are a material income producing factor); (2) certain C corporations with average annual gross receipts of \$5 million or less in which inventories are not a material income producing factor; and (3) certain taxpayers with average annual gross receipts of \$10 million or less. Provided inventories are not a material income producing factor, sole proprietors, limited liability companies (LLCs), partnerships, and S corporations can change to the cash method of accounting without regard to their average annual gross receipts.

Installment Sales: Generally, a sale occurs when you transfer property. If a gain will be realized on the sale, income recognition will normally be deferred under the installment method until payments are received, so long as one payment is received in the year after the sale. So if you are expecting to sell property prior to the end of 2016, and it makes economic sense, consider selling the property and report the gain under the installment method to defer payments (and tax) until next year or later.

Delay Billing: If you are on the cash method, delay year-end billing to clients so that payments are not received until 2017.

Interest and Dividends: Interest income earned on Treasury securities and bank

certificates of deposit with maturities of one year or less is not includible in income until received. To defer interest income, consider buying short-term bonds or certificates that will not mature until next year. Unless you have constructive receipt of dividends before year-end, they will not be taxed to you in 2016. If you have control or influence over when dividends are paid to you, we should discuss this when we meet.

■ Accelerating Income into 2016

You may benefit from accelerating income into 2016. For example, you may anticipate being in a higher tax bracket in 2017, or perhaps you need additional income in 2016 to take advantage of an offsetting deduction or credit that will not be available to you in future tax years. Note, however, that accelerating income into 2016 could be disadvantageous if you expect to be in the same or lower tax bracket for 2017.

If you report business income and expenses on a cash basis, issue bills and pursue collection before the end of 2016. Also, see if some of your clients or customers are willing to pay for January 2017 goods or services in advance. Any income received using these steps will shift income from 2017 to 2016.

Qualifying Dividends: Qualified dividends are subject to rates similar to the capital gains rates. Qualified dividend income is subject to a 15% rate for taxpayers below the 39.6% tax bracket. For taxpayers in the 39.6% bracket, the rate is 20%. Note that qualified dividends may be subject to an additional 3.8% net investment income tax. Qualified dividends are typically dividends from domestic and certain foreign corporations. The corporate board may consider the tax impact of declaring a dividend on its shareholders. If you are not in the highest bracket for 2016,

but you expect to be in 2017, consideration should be made as to authorizing any dividend payment prior to the end of 2016 to utilize the 15% favorable tax rate vs. the 20% rate at higher income levels.

■ Accelerating Business Deductions

Bad Debts: If you use the accrual method, you can accelerate deductions into 2016 by analyzing your business accounts receivable and writing off those receivables that are totally or partially worthless. By identifying specific bad debts, you should be entitled to a deduction. You may be able to complete this process after year-end if the write-off is reflected in the 2016 year-end financial statements. For non-business bad debts (such as uncollectible loans), the debts must be wholly worthless to be deductible, and will probably only be deductible as a capital loss.

2016 Bonuses: In general, if you are paying a bonus to employees, you may accrue that liability and deduct that amount if all the events are satisfied that fix that liability even though you pay the bonus next year, and you do not have a unilateral right to cancel the bonus at any time prior to payment. Generally, you will accelerate the bonus deduction into 2016 while your employees will report the income in 2017 if they are cash method taxpayers. Also, any compensation arrangement that defers payment will be currently deductible only if paid within 2 ½ months after the employer's year-end.

■ Highlights of Tax Credits

Research and Development Tax Credit: Beginning in 2016, eligible small businesses (\$50 million or less in gross receipts) may claim the research and development tax credit against alternative minimum tax liability, and the credit can be used by certain

small businesses against the employer's payroll tax (i.e., FICA) liability.

Employer Wage Credit for Employees in the Military: Some employers continue to pay all or a portion of the wages of employees who are called to active military service. The amount of the credit is equal to 20% of the first \$20,000 of differential wage payments to each employee for the taxable year. Beginning in 2016, employers of any size with a written plan for providing such differential wage payments are eligible for the credit.

Work Opportunity Credit: The work opportunity credit is an incentive provided to employers who hire individuals in groups whose members historically have had difficulty obtaining employment. The credit gives a business an expanded opportunity to employ new workers and to be eligible for a tax credit based on the wages paid. The credit is available for first-year wages paid or incurred for employees hired and who began work during certain years the credit was available. Employers who hire qualified long-term unemployed individuals (i.e., those who have been unemployed for 27 weeks or more) will be entitled to an increased credit amount (i.e., 40% of the first \$6,000 of wages) for new hires that begin to work for an employer on or after January 1, 2016 through December 31, 2019.

■ **S Corporations**

S Corporation Built-In Gains Tax Recognition Period: An S corporation generally is not subject to tax; instead, it passes through its income or loss items to its shareholders, who are taxed on their pro-rata shares of the S corporation's income. However, if a business that was formed as a C corporation elects to become an S corporation, the S corporation is taxed at the highest corporate rate on all

unrealized gains that were built-in at the time of the election for a defined recognition period of five years.

Basis Adjustment to Stock of S Corporations Making Charitable Contributions of Property: The basis of an S corporation shareholder's stock is decreased by charitable contributions of property by the S corporation in an amount equal to the shareholder's pro rata share of the adjusted basis of the contributed property. For example, if an S corporation contributes property with a \$200 adjusted basis and \$500 fair market value to a charity when its sole shareholder has a \$500 stock basis, the shareholder's stock basis is reduced by \$200 instead of \$500.

■ **Business Deductions**

Equipment Purchases: If you purchase equipment, you may make a "§179 election," which allows you to expense (i.e., currently deduct) otherwise depreciable business property, including computer software and qualified real property. Air conditioning and heating units placed in service during tax years beginning in or after 2016 are eligible for this deduction. You may elect to expense up to \$500,000 of equipment costs (with a phase-out for purchases in excess of \$2,010,000), and the deduction is subject to a business income limit.

If the cost of your §179 property placed in service during 2016 is \$2,510,000 or more, you cannot take a §179 deduction.

In addition, careful timing of equipment purchases can result in favorable depreciation deductions in 2016. In general, under the "half-year convention," you may deduct six months' worth of depreciation for equipment that is placed in service on or before the last day of the tax year. (If more

than 40% of the cost of all personal property placed in service occurs during the last quarter of the year, however, a “mid-quarter convention” applies, which lowers your depreciation deduction.)

Bonus Depreciation: For property acquired and placed in service during 2016 through 2019 (with an additional year for certain property with a longer production period), the bonus depreciation percentage is 50% for property placed in service during 2016 and 2017 is scheduled to phase down to 40% in 2018, and to 30% in 2019.

Self-Employed Health Insurance Premiums: Self-employed individuals may claim 100% of the amount paid during the taxable year for insurance that constitutes medical care for themselves, their spouses, and dependents as an above-the-line deduction, without regard to the general 10%-of-AGI floor. Self Employed Health Insurance includes eligible long term health care premiums.

Vehicles Weighing Over 6,000 Pounds: A popular strategy in recent years is to purchase a vehicle for business purposes that exceeds the depreciation limits set by statute (i.e., a vehicle rated over 6,000 pounds). Doing so would not subject the purchase to the statutory dollar limit for depreciation: \$3,160 for 2016; \$3,560 in the case of vans and trucks (if bonus depreciation is taken, the 2016 amounts increase to \$11,160 for cars and \$11,560 for vans and trucks). Therefore, the vehicle would qualify for the full equipment expensing dollar amount. However, for SUVs (rated between 6,000 and 14,000 pounds gross vehicle weight) the expensing amount is limited to \$25,000.

Capitalization of Tangible Property: Recent rules clarify whether certain items you

purchase for use in your business (i.e. copiers, computers) can be expensed in the year purchased, or must be capitalized and deducted over several years. The rules include certain elections that may simplify your recordkeeping and/or increase your current deductions. We should discuss these rules when we meet.

Domestic Production Activities Deduction: Businesses that engage in domestic production activities are allowed to deduct a certain percentage of their qualified production activities income. The domestic production activities deduction is available to corporations and individuals, as well as to owners of partnerships and S corporations. The deduction may also be effective for state tax purposes, although some states may decide to “decouple” from the federal deduction in order to avoid a loss of business tax revenue. Whether you qualify for the deduction depends on the nature of your business.

Home Office Deduction: Expenses attributable to using the home office as a business office are deductible if the home office is used regularly and exclusively: (1) as a taxpayer's principal place of business for any trade or business; (2) as a place where patients, clients, or customers regularly meet or deal with the taxpayer in the normal course of business; or (3) in the case of a separate structure not attached to the residence, in connection with a trade or business. If you have been using part of your home as a business office, we should talk about the amount of any deduction you would like to take because an IRS safe harbor could be used to minimize audit risk.

NOL Carryback Period: If your business suffers net operating losses for 2016, you generally apply those losses against taxable

income going back two tax years. Thus, for example, the loss could be used to reduce taxable income—generating tax refunds—for tax years as far back as 2014. Certain “eligible losses” can be carried back three years; farming five years. A corporation may file Form 4466, Corporation Application for Quick Refund of Overpayment of Estimated Tax, to recover any overpayment of estimated tax for the tax year over the final income tax liability expected for the tax year. If you are expecting a tax loss for the current year and have paid estimated taxes, we should discuss this process as to quickly recover your cash payments. For losses expected to be incurred on an individual return, the filing of Form 1045, Application for Tentative Refund may be applicable.

Inventories Subnormal Goods: You should check for subnormal goods in your inventory. These are goods that are unsalable at normal prices or unusable in the normal way due to damage, imperfections, shop wear, changes of style, odd or broken lots, or other similar causes, including second-hand goods taken in exchange. If your business has subnormal inventory as of the end of 2016, you can take a deduction for any write-downs associated with that inventory provided you offer it for sale within 30 days of your inventory date. The inventory does not have to be sold within the 30-day timeframe.

■ **Business Credits**

Small Employer Pension Plan Startup Cost Credit: Certain small business employers that did not have a pension plan for the preceding three years may claim a nonrefundable income tax credit for expenses of establishing and administering a new retirement plan for employees. The credit applies to 50% of qualified administrative and retirement-education expenses for each of the first three

plan years. However, the maximum credit is \$500 per year.

Employer-Provided Child Care Credit: For 2016, employers may claim a credit of up to \$150,000 for supporting employee child care or child care resource and referral services. The credit is allowed for a percentage of “qualified child care expenditures,” including for property to be used as part of a qualified child care facility, for operating costs of a qualified child care facility, and for resource and referral expenditures.

■ **Health Care and Other Employee Benefit Planning**

SHOP Exchanges: In 2016, the Small Business Health Options Program generally is available for employers with 50 or fewer full-time equivalent employees. Coverage must be offered to all full-time employees working 30 or more hours per week. Each exchange will offer its own SHOP marketplace. Self-employed persons with no employees cannot use the SHOP Exchange.

Credit for Employee Health Insurance Expenses of Small Employers: Eligible small employers are allowed a credit for certain expenditures to provide health insurance coverage for their employees. Generally, employers with 10 or fewer full-time equivalent employees (FTEs) and an average annual per-employee wage of \$25,900 or less are eligible for the full credit. In 2016, the credit amount begins to phase out for employers with either 11 FTEs or an average annual per-employee wage of more than \$25,900. The credit is phased out completely for employers with 25 or more FTEs or an average annual per-employee wage of \$51,800 or more. The credit is available on a sliding scale for up to 50% of the employer's contribution toward employee health

insurance premiums, is only allowable if the health insurance is purchased through a Small Business Health Options Program (SHOP) Exchange. The credit is available only for two consecutive taxable years after 2013, so it is not available to you if you or a predecessor claimed it for 2014 and 2015.

Pay to Play Excise Tax: For the 2016 plan year, if you have 50 or more employees, you could be subject to an excise tax, as much as \$2,160 per full-time employee, for failure to offer a health care plan that is minimum essential coverage to at least 95% of your full-time employees if at least one employee obtains subsidized coverage through a public health insurance exchange. The first 30 workers are excluded from the penalty excise tax. If you do offer coverage but it is not adequate or is unaffordable, the excise tax could be \$3,390 for each full-time employee who obtains subsidized coverage through an exchange. Larger employers should be considering their health care plan option in light of this potential excise tax liability.

Health Care Reporting: Filings for 2016 Form 1095-C and Form 1094-C, generally for employers with 50 or more full-time equivalent employees, and Form 1095-B and Form 1094-B, for employers with self-insured plans and other providers of minimum essential coverage, are due earlier for 2016, specifically by February 28, 2017 if you are filing on paper, or by March 31, 2017, if you are filing electronically. Statements to employees are due by January 31, 2017.

Permissible Mid-Year Changes to Safe Harbor Qualified Plans: The IRS provided in 2016 additional guidance on mid-year changes to a safe harbor plan under §401(k) and §401(m) of the IRC. The notice provides that a mid-year change either to a safe harbor plan or to a plan's safe harbor notice does not

violate the safe harbor rules merely because it is a mid-year change, provided that applicable notice and election opportunity conditions are satisfied and the mid-year change is not a prohibited mid-year change, as described in the notice. If mid-year changes to your plans are necessary, discuss this with your qualified plan advisor.

■ **Reporting**

Tax Returns: For C corporations reporting on a calendar year, the 2016 filing deadline is now on or before April 15th. For C corporations reporting on a fiscal year other than one ending June 30, the filing date is the 15th day of the fourth month following the close of the taxable year. For June 30 fiscal year C corporation filers, the filing deadline remains the 15th day of the third month following the close of the taxable year (September 15). Effective for returns for tax years beginning after December 31, 2016 and before January 1, 2026, there is an automatic five month extension for calendar year C corporations, and an automatic seven month extension for fiscal-year C corporations with a taxable year ending on June 30. After 2025, both extensions become six months. For partnerships reporting on a calendar year, the filing deadline is March 15th, and for partnerships reporting on a fiscal year, the filing deadline is the 15th day of the third month following the close of the fiscal year. The reporting deadlines for S corporations have not changed and remains March 15th or the 15th day of the third month following the close of the taxable year for fiscal year S corporations.

FBAR: U.S. persons holding any financial interest in, signature or other authority over, a foreign financial account exceeding \$10,000 at any time in a calendar year must file a Report of Foreign Bank and Financial

Accounts (FBAR) with the Treasury Department. The 2016 due date is the U.S. tax filing deadline of April 15, 2017 (unless extended by a weekend or holiday), with a max six-month extension to October 15.

FATCA: The Foreign Account Tax Compliance Act (FATCA) requires reporting and possible withholding on payments made to foreign entities, whether the foreign payees are financial institutions or not. Compliance processes need to be in place in advance of making any payments to foreign entities.

Uncertain Tax Positions: A corporation must file Schedule UTP to disclose certain uncertain tax positions with its income tax return if it: (1) files Form 1120, Form 1120-F, Form 1120-L, or Form 1120-PC; (2) has assets of \$10,000,000; (3) issued (or a related party issued) audited financial statements reporting all or a portion of the corporation's operations for all or a portion of the corporation's tax year; and (4) has one or more tax positions that must be reported on Schedule UTP. A taxpayer that files a protective Form 1120, Form 1120-F, Form 1120-L, or Form 1120-PC and satisfies the conditions set forth above also must file Schedule UTP.

■ **Electronic Deposits**

Electronic Funds Transfer: A corporation must make its deposits of income tax withholding, FICA, FUTA, and corporate income tax by electronic funds transfer (EFT), including through the IRS's Electronic Federal Tax Deposit System (EFTPS).

■ **Estimated Tax Payments**

A corporation (other than a large corporation) or an individual taxpayer (or single-member LLC that is treated as a disregarded entity)

generally may be able to avoid any underpayment penalties by paying estimated taxes based on 100% of the tax shown on the prior year return. A large corporation is a corporation that had taxable income of \$1 million or more for any of the three tax years immediately preceding the current year. If an individual's adjusted gross income as shown on the tax return for the preceding tax year exceeds \$150,000 (\$75,000 in the case of a married individual who files separately), the amount of the required installment is generally increased to 110% of the tax shown on the prior year's return. Otherwise, such corporations or individuals generally must pay estimated taxes based on 100% of the current year's tax; an income tax projection should be completed in order to determine the best option.

A corporation or an individual using the cash method of accounting may want to consider paying their fourth quarter state estimated taxes before December 31st, rather than in the first quarter of next year, if they are able to use a state income tax deduction for the current year. An income tax projection is necessary to determine the best option.

An SDDCO tax profession will be happy to meet with you to discuss the strategies outlined above. There is still time to implement these strategies to minimize your 2016 tax liability.