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Year-End Tax Planning for Business

Several significant tax law changes took effect in 2016 that may affect your business's federal tax filings in 2017. As the year draws to a close, we should review these changes, as well as your business's projected taxable income or loss to see what actions might be appropriate before year end to reduce taxes. It's also important to ascertain whether enough estimated taxes have been paid to avoid any underpayment of estimated tax penalties.

Accelerated Filing Deadlines for Forms W-2, W-3, and Form 1099-MISC

New for 2016, the deadline for filing both electronic and paper Forms W-2 to employees and to the Social Security Administration (SSA) is January 31, 2017. Previously, the deadline was the end of February to file paper Forms W-2 with the SSA and until the end of March to make electronic filings. The January 31 deadline also applies to Forms W-2AS, W-2GU, W-2VI, W-3 and W-3SS.

If you are filing any Forms 1099-MISC and reporting an amount in Box 7, Nonemployee Compensation, the deadline for filing these forms has also been moved up to January 31, 2017. If you are not reporting an amount in Box 7, the deadline remains February 28 for paper filings and March 31 for electronic filings.

Extensions of time to file Forms W-2 with the SSA are no longer automatic. For filings due on or after January 1, 2017, you may request one 30-day extension and the IRS will only grant the extension in extraordinary circumstances or catastrophe. An extension of time to furnish Forms W-2 to employees may be requested by sending a letter to the IRS, but if an extension is for more than 10 employees, the request must be filed electronically. Requests for an extension of time to furnish Forms W-2 to employees are not automatically granted. If approved, an extension will generally be for no more than 15 days from the due date, unless the need for up to a total of 30 days is clearly shown.

Increased Penalties for Failure to Timely File Certain Information Returns

In addition to the accelerated filing deadlines for 2016 Forms W-2, Forms W-3, and Forms 1099-MISC, higher penalties apply for (1) the failure to file correct Forms W-2 by the due date; (2) the intentional disregard of filing requirements; (3) the failure to furnish Forms W-2; and (4) the intentional disregard of payee statement requirements. In addition to applying to Forms W-2, W-3, and 1099-MISC, other common forms subject to these increased penalties include: Schedules K-1 for Forms 1041, 1065, and 1120S.

Penalties for the late filing of these information returns have also increased. For each information return or payee statement with respect to which a failure occurs, the penalty has been increased from $100 to $250, and the maximum penalty that may be imposed has been increased from $1,500,000 to $3,000,000. The per-failure penalty for intentionally disregard the filing requirements also has been increased, from $250 to $500.

Change in Return and Extension Due Dates for C Corporations and Partnerships

In general, C corporations with tax years ending in 2016 now have an extra month to file their federal income tax returns. Such returns are due by the 15th day of the fourth month following the close of the tax year, rather than the 15th day of the third month following the close of the tax year. Thus, 2016 calendar-year C corporation federal income tax returns are due April 18, 2017, due to April 15 falling on a Saturday and Monday, April 17 being Emancipation Day in the District of Columbia.

A special rule exempts C corporations with fiscal years ending on June 30 from this change until tax years beginning after December. 31, 2025. Thus, the filing deadline for such corporations remains September 15 until 2026 (when it will change to October 15).

Partnerships with tax years ending in 2016 are now required to file their federal income tax returns by the 15th day of the third month following the close of the tax year, rather than the 15th day of the fourth month following the close of the tax year. Thus, 2016 calendar-year partnership federal income tax returns are due March 15, 2017.

Along with the changes in tax return deadlines, many of the automatic extension periods have also changed. For calendar year C corporations, the new rules provide for a five-month automatic extension. The extension period is a month shorter, but results in the same September 15 extended deadline for a calendar year C corporation because of the new due date for C corporation returns (i.e., April 15).

For fiscal year C corporations with tax years ending on dates other than June 30, the length of automatic extensions remains unchanged at six months. For fiscal year C corporations with tax years ending on June 30, a special seven-month automatic extension applies for tax years beginning after 2015 and ending before 2026.

While partnerships were previously allowed a five-month extension of time in which to file their tax returns, they are now allowed a six-month extension so that the extended due date is the same as under prior law (i.e. September 15).

The filing deadline for S corporation returns remains unchanged, meaning that partnerships and S corporations will now share the same due dates.

Code Sec. 179 Expense Deduction and Bonus Depreciation

Two of the biggest deductions available to a business are the Code Sec. 179 expense deduction and bonus depreciation. For 2016, the maximum amount of qualifying property that your business can expense is $500,000. That amount is reduced one-for-one to the extent qualifying property purchased exceeds $2,020,000.

New for 2016 tax returns, air conditioners and heating units now qualify for the Code Sec. 179 expense deduction.

The 50 percent bonus depreciation deduction is again available for 2016. Combined with the Code Sec. 179 deduction, bonus depreciation can provide your business with significant reductions in taxable income. For example, if your business purchased $800,000 of qualifying equipment, the total first year deduction would be $680,000 ($800,000 - $500,000 (maximum Code Sec. 179 deduction) - $150,000 (50% depreciation x remaining basis of $300,000) - $30,000 (normal depreciation of 20% x remaining basis of $150,000).

In addition, if your business filed its 2014 return (or its 2015 short year return) before the enactment of last year's tax extenders bill on December 18, 2015, your business may be able to retroactively elect to take the 50-percent bonus depreciation deduction for qualified property placed in service during the 2015 portion of fiscal years beginning in 2014. If you think you might be eligible, we should meet to discuss the possibility of electing the retroactive bonus depreciation.

Safe Harbor for Deducting Remodeling Costs Incurred by Retail and Restaurant Businesses

Late last year, the IRS provided a safe harbor that allows a retail or restaurant business to deduct 75 percent of the qualified costs incurred in performing a remodeling project on a qualified building. The business must capitalize the remaining 25 percent of the costs and recover them through depreciation. Previously, the deductibility of such costs were controversial and the subject of scrutiny in an audit. There are a number of conditions on using this safe harbor so, if you think you have costs that may qualify for this safe harbor, we should review the requirements that must be met in order to deduct such costs.

Increase in De Minimis Repair Amounts That May Be Expensed

Under a safe harbor in the repair and capitalization rules that took effect in 2014, certain amounts that a business pays for tangible property acquired or produced during the tax year may be deducted, rather than capitalized, provided certain requirements are met and the cost of the property does not exceed a de minimis amount. Effective for 2016, the IRS increased the de minimis amount that is deductible by such businesses from $500 to $2,500.

The new $2,500 threshold applies to items substantiated by an invoice. As a result, your business may be eligible to immediately deduct many expenditures that would otherwise need to be spread over a period of years through annual depreciation deductions. Whether you can benefit from this change in the current year depends on your financial picture. In addition, if your business does want to take advantage of the increase in the de minimis limitation, an election must be made and the business's accounting procedures may need to be modified.

Research Tax Credit Made Permanent

Last year's tax extender legislation permanently extended the popular research tax credit. Additionally, beginning in 2016, small businesses may claim the credit against alternative minimum tax (AMT) liability. Also beginning in 2016, this credit can be utilized by certain qualifying startup businesses against the employer's payroll tax liability.

And, it is worth noting that two taxpayer-favorable court cases rejected IRS attempts to rein in taxpayers' ability to take full advantage of this credit. If you've taken research tax credits in the past couple of years, it may be worthwhile to review the calculation of those credits in light of these cases to see if additional expenses can be claimed based on the court holdings.

Vehicle Deductions and Substantiation

Deductions for vehicle-related expenses are an important part of most business tax returns. Whether such deductions pass scrutiny with the IRS depends on whether the business complies with the strict substantiation requirements necessary for such deductions. With respect to deductions relating to vehicles, we need to ensure that your business records include the following information with respect to each vehicle used in the business: (1) the amount of each separate expense with respect to the vehicle (e.g., the cost of purchase or lease, the cost of repairs and maintenance); (2) the amount of mileage for each business or investment use and the total miles for the tax period; (3) the date of the expenditure; and (4) the business purpose for the expenditure. The following are considered adequate for substantiating such expenses: (1) records such as an account book, diary, log, statement of expense, or trip sheets; and (2) documentary evidence such as receipts, canceled checks, bills, or similar evidence.

Records are considered adequate to substantiate the element of an expense only if the records are prepared or maintained in such a manner that each recording of an element of the expense is made at or near the time the expense is incurred.

Accountable Plans

By using an accountable plan, your business can reimburse employees for business expenses such as travel, meals, entertainment and other costs without reporting the reimbursements as taxable compensation. This can help reduce employment taxes on such payments. However, in order for a plan to be considered an eligible reimbursement plan, it must satisfy certain requirements.

Fringe Benefits

You may want to consider using benefits rather than higher wages to attract employees. Certain fringe benefits paid under a qualified fringe benefit plan are deductible by your business and are not taxable as compensation to the employee, thus avoiding employment taxes that would otherwise be paid on the additional compensation. Retirement plans are particularly attractive to potential employees. By starting a retirement savings plan, you not only help your employees save for the future but also attract and retain quality employees. In addition to providing deductions to your business, a tax credit is available to small employers for the costs of starting a retirement plan.

S Corporation Salaries

For any business operating as an S corporations, it's important to ensure that shareholders involved in running the business are paid an amount that is commensurate with their workload. Distributing profits instead of paying compensation subject to employment taxes, is an area that the IRS targets on such returns. Failing to do so can lead not only to tax deficiencies, but penalties and interest on those deficiencies as well. The key to establishing reasonable compensation is determining what type of work you did for the S corporation as an employee-shareholder. If you are in this situation, we need to document the factors that support the salary you are being paid.

Planning for Revised Partnership Audit Procedures

Effective for partnership tax years beginning after 2017, the current partnership audit procedures will be replaced with a single centralized audit system. While some partnerships may elect out of the new regime, most partnerships will be subject to the new rules. Under the new system, the IRS will examine a partnership's items of income, gain, loss, deduction, credit and partners' distributive shares for a particular year of the partnership (i.e., the reviewed year). Any adjustments are taken into account by the partnership, and not the individual partners, in the year that the audit or any judicial review is completed (i.e., the adjustment year). Thus, it's possible for current year partners to be liable for mistakes or errors committed in prior years when they were not partners. The new rules provide certain exceptions that can allow current year partners to escape such liability, including an election that must be made no later than 45 days after the date of a notice of final partnership adjustment. The bottom line is that partnership agreements should be reviewed and revised to take into account the new audit rules, and that is best done sooner rather than later.

Please call us at your convenience so we can set up an appointment and discuss your business's tax situation before year end.

Sincerely,

Lichtenstein, Briefman Gardner & Thomas PLLC
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