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ACCOUNTING • TAXES

2016 BUSINESS TAX PLANNING

We hope that you are doing well and that business is exceeding your expectations in 2016. It is hard to believe that it is mid-December and this year is quickly coming to a close. We wanted to take this time to go over a few year-end tax planning strategies and some important updates concerning your business tax situation. The following are some items you may want to consider with respect to your 2016 business tax planning.

RETIREMENT PLANNING

As year-end approaches, this is a good time to be sure you are funding your retirement programs to the fullest extent. The amount of contributions varies depending on the type of plan the business has implemented. Some common limits are 401(k)/403(b) limit: $18,000 if under 50 years old, $24,000 if over 50 years old; Simple limit $12,500 if under 50 years old, $15,500 if over 50 years old. Please contact us if you would like to confirm that you will maximize the funding of your retirement plans for 2016. Also, let us know if you would like to review your current retirement plan and evaluate other options.

UPDATE QUICKBOOKS/SAGE OR OTHER ACCOUNTING SOFTWARE

Now would be a good opportunity to review your QuickBooks records or other accounting software such as Sage to see if there are any outstanding bookkeeping issues that need to be dealt with before the end of the year; such as bank reconciliations, payroll reconciliations, new asset purchases, recording new loans, adding last year's adjusted journal entries, and adjusting A/R and A/P. It's a lot easier on all of us if these issues are dealt with before the rush of tax season deadlines.

REASONABLE COMPENSATION FOR OFFICERS

The IRS has increased audit activity to confirm that S-Corp. owners are paying reasonable compensation to the owners/officers. We suggest that you review your current officer's compensation structure to be sure you are avoiding any unnecessary risk of facing an IRS audit. The IRS concern is that S-Corporations are avoiding an excessive amount of payroll taxes (Social Security & Medicare Tax). A potential strategy to reduce any risk would be to pay a year-end bonus if the current officer compensation is significantly lower than shareholder distributions. Please let us know if you have any concerns in this area.

DEPRECIATION

One of the biggest tax benefits to a business is the Section 179 deduction, which allows taxpayers to write off property purchases that would otherwise be capitalized and depreciated over time. Currently, for property placed in service in 2016, the Section 179 expense deduction is capped at $500,000. It's still worthwhile to evaluate whether it's appropriate in your situation to increase capital improvement purchases to take advantage of this deduction. New for 2016 tax returns, air conditioners and heating units now qualify for the Code Sec. 179 expense.

INCREASE IN DE MINIMIS EQUIPMENT PURCHASES THAT MAY BE EXPENSED

Under a safe harbor 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.

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Effective for 2016, the IRS increased the de minimis amount that is deductible by most 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.

DEDUCTION OF REMODELING AND TENANT IMPROVEMENT COSTS

IRS provided a safe harbor that allows certain businesses to deduct qualified costs incurred in performing a remodeling project or tenant improvements on a qualified building. 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.

ACCURATE ASSET DISPOSALS

Please review your 2016 asset listing attached to your tax return closely and let us know if any of the property on the 2015 tax return has been disposed. This will aid in the preparation of your County/City Personal Property tax returns and ensure that you are not being taxed on equipment that is no longer in service. Henrico/City of Richmond/Chesterfield personal property tax returns and business license renewals are due March 1, 2017 (Hanover is due May 1, 2017). If we are preparing the returns please make sure we have the information by **February 1, 2017**.

REVENUE AND EXPENSE TIMING

If you are a cash basis taxpayer, the revenue and expenses reported on your tax returns are recorded when they are received and paid. The timing of when you receive payments from customers and make payments to vendors can greatly alter the amount of revenue and expenses your business is required to report. Please contact us if you are considering shifting your income to reduce your flow-through income.

CHILDREN WORKING IN BUSINESS

Children working in closely-held businesses can offer a tax planning opportunity and potentially be targeted toward educational planning. The wages paid to children working in your closely-held business are tax deductible. The amount of compensation must be reasonable. Children can earn approximately $6,400 without paying individual income taxes. This would allow your children to supplement educational planning without incurring additional income tax liability. The business would benefit from the deduction of the wages paid to your children. If you have school-aged children working in your business, please let us know so we can help you determine if they should be added to the payroll.

CREDITS

Business credits are available for certain energy efficiency improvements; disabled access improvements, and adding certain employees under the work opportunity credits. Please let us know if you have made access improvements to your facilities and/or equipment, completed any energy efficiency upgrades, or added to your staff with any workers from certain veteran/disadvantaged groups.

INCREASED PENALTIES FOR FAILURE TO TIMELY FILE 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.

CHANGES MADE TO TAX RETURN DUE DATES

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 15th falling on a Saturday and Monday, April 17th being Emancipation Day in the District of Columbia. A special rule exempts C corporations with fiscal years ending on June 30th from this change until tax years beginning after December 31, 2025. Thus, the filing deadline for such corporations remains September 15th until 2026 (when it will change to October 15th).

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. 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.

All business returns that go on extension will be due September 15, 2017.

VEHICLE DEDUCTIONS AND SUBSTANTIATION

Expenses relating to vehicles used in a business can add up to major deductions. The deductible vehicle expenses of a business are generally calculated using one of two methods: the standard mileage rate method or the actual expense method. If the standard mileage rate is used, parking fees and tolls incurred for business purposes can be added to the total amount calculated.

Since the IRS tends to focus on vehicle expenses in an audit and disallow them if they are not property substantiated, you should ensure that the following are part of your tax records with respect to each vehicle used in your 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 such as an account book, diary, log, statement of expense, or trip sheet 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.

MISCELLANEOUS TAX CONSIDERATIONS

Other considerations for 2016 and 2017 include the following:

(1) The 100 percent exclusion from gross income of gain from the sale of small business stock;

(2) The reduction to five years of the recognition period for the built-in gains of S corporations;

(3) The deduction for charitable deductions of food inventory by taxpayers other than C corporations;

(4) The expensing allowance for certain film and television productions and the cost of live theatrical productions;

(5) The deduction for income attributable to domestic production activities in Puerto Rico;

(6) Tax rules relating to payments between controlled foreign corporations and dividends of regulated investment companies;

(7) The subpart F income exemption for income derived in the active conduct of a banking, finance, or insurance business;

(8) The tax rule exempting dividends, interest, rents, and royalties received or accrued from certain controlled foreign corporations by a related entity from treatment as foreign holding company income;

(10) The classification, for depreciation purposes, of certain race horses as three-year property;

(11) The basis adjustment rule for stock of an S-Corporation making charitable contributions of property;

(12) The classification, for depreciation purposes, of motorsports entertainment complexes as seven-year property; and

(13) Tax incentives for investment in empowerment zones.

Let us know if you have any questions, or if you require any clarification of any of these subjects. We wish you a successful conclusion to 2016.

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