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Year-End Tax Planning Strategies For Businesses

As 2015 draws to a close, there is still time to reduce your 2015 tax bill and plan ahead for 2016. This letter highlights several potential tax-saving opportunities for business owners to consider.

Deferring Income into 2016

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 2015 than in 2016, or if you anticipate being in the same or a higher tax bracket in 2015 than in 2016, you may benefit by deferring income into 2016. Of course, in the case of an individual exposure to the alternative minimum tax could reverse the standard planning. 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 if you sell property prior to the end of 2015 and will receive payments in future years, you should consider reporting the gain on the property using 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 2016.

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 2015.

Accelerating Income into 2015

You may benefit from accelerating income into 2015. For example, you may anticipate being in a higher tax bracket in 2016, or perhaps you need additional income in 2015 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 2015 could be disadvantageous if you expect to be in the same or lower tax bracket for

2016.

If you report your business income and expenses on a cash basis, issue bills and pursue collection before the end of 2015. Also, see if some of your clients or customers are willing to pay for January 2016 goods or services in advance. Any income received using these steps will shift income from 2016 to 2015.

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 2015, but you expect to be in 2016, consideration should be made as to authorizing any dividend payment prior to the end of 2015 to utilize the 15% favorable tax rate vs. the 20% rate at higher income levels.

Business Deductions

Self-Employed Health Insurance Premiums: Self-employed individuals are allowed to claim 100% of the amount paid during the taxable year for insurance that constitutes medical care for themselves, their spouses, and their 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.

Equipment Purchases: If you purchase equipment, you may make a “Section 179 election,” which allows you to expense (i.e., currently deduct) otherwise depreciable business property. For 2015, you may elect to expense up to $25,000 of equipment costs (with a phase-out for purchases in excess of $200,000) if the asset was placed in service during 2015.

Although the amount eligible to be expensed and the phaseout amount were significantly greater in prior years, there is a chance the 2015 figures will go up if Congress acts soon. However, it is uncertain whether any such legislation will be passed and if so whether that legislation would have retroactive application.

In addition, careful timing of equipment purchases can result in favorable depreciation deductions in 2015. 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.)

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, $3,160 for 2015; $3,460 in the case of 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.

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 2015, 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—and thus generate tax refunds—for tax years as far back as 2013. Certain "eligible losses" can be carried back three years; farming losses can be carried back five years.

Bad Debts: If you use the accrual method, you can accelerate deductions into 2015 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 2015 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.

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.

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 $25,800 or less are eligible for the full credit. In 2015, the credit amount begins to phase out for employers with either 11 FTEs or an average annual per-employee wage of more than $25,800. The credit is phased out completely in 2015 for employers with 25 or more FTEs or an average annual per-employee wage of $51,600 or more. For 2015, 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 (SHOP) Exchange, and is only available for two consecutive taxable years.

Employer-Provided Child Care Credit: For 2015, 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.

Inventories

Subnormal Goods: You should check for subnormal goods in your inventory. Subnormal goods 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 2015, 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.

Planning for 2015 Tax Increases and Potential Expiration of Tax Relief Provisions

S Corporation Built-In Gains Tax: 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 if the gains are recognized during a special holding period which is generally 10 years. Although the special holding period was significantly shorter in recent years, it is uncertain whether legislation will be passed to shorten the special holding period for 2015 or subsequent years and, if passed, whether that legislation would have retroactive application.

Basis Adjustment to Stock of S Corporations Making Charitable Contributions of Property: The rule that 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 expired for contributions made in taxable years beginning after December 31, 2014. As a result, absent congressional action retroactively extending the prior rule for charitable contributions made in 2015, your stock basis will be reduced by your pro rata share of the S corporation's charitable contributions. For example, if you contributed property with a $200 adjusted basis and $500 fair market value to a charity, your stock basis will be reduced by $500 instead of $200 unless Congress enacts legislation extending the prior rule.

Exclusion of Gain Attributable to Certain Small Business Stock: Stock acquisitions that qualify as “small business stock” under § 1202 are subject to special exclusion rules upon their sale as long as a five-year holding period is satisfied. For qualified small business stock sold in 2015, the five-year look-back period is to 2010. A 50% exclusion applies for qualified small business stock acquired before February 18, 2009, and after December 31, 2014. A 75% exclusion applies for qualified small business stock acquired after February 17, 2009, and before September 28, 2010. A 100% exclusion applies for qualified small business stock acquired after September 27, 2010, and on or before December 31, 2014. For qualified small business stock acquired in 2015, only 50% of the gain is excluded from gross income (after the five-year holding period is met). Unless Congress acts before the end of 2015 to reinstate the 100% exclusion for stock acquired in 2015 (and held for at least five years), gain on the sale of such stock acquired in 2015 may be subject to the 50% exclusion rate.

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. If the employer has fewer than 50 employees and has a written plan for providing such differential wage payments, the employer is eligible for a credit. 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. The credit expired at the end of 2014 and it is uncertain whether legislation providing for this credit will be passed and if so whether such legislation will provide for the credit retroactively.

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 on or before December 31, 2014. The credit expired at the end of 2014 and it is uncertain whether legislation providing for this credit will be passed and if so whether such legislation will provide for the credit retroactively.

Health Care Planning

SHOP Exchanges: In 2016, the Small Business Health Options Program is available for employers with 100 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.

Premium Health Care Credits: Small businesses with less than 25 employees may qualify for health care tax credits using the health insurance marketplace. These premium tax credits can cover up to 50% of the cost of employee health insurance. The uncovered amount can be deducted from your taxes as usual. The tax credits are available through plans offered on the SHOP marketplace exclusively.

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, which could be as much as $2,000 per employee, for failure to provide an adequate health care plan to your employees. The first 30 workers are excluded from the penalty excise tax. Larger employers, should be considering their health care plan needs in light of this potential excise tax liability.

Health Care Reporting: The first mandatory filings for 2015 Forms 1095-C, 1095-B, 1094-C and 1094-B are due in early 2016. Paper filings are due February 29, 2016, or March 31, 2016, if filing electronically. Employee statements are due February 1, 2016.

Reporting

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. Starting in 2014, you needed to be compliant with FATCA beginning July 1st for withholding purposes. Information reporting requirements applied to foreign payments beginning in 2014, with the initial reports due March 15, 2015. Implementing a compliance process for FATCA can be costly. Your 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, From 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, 1120-F, 1120-L, or 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).

If you have any questions, please do not hesitate to call. There is still time to implement these strategies to minimize your 2015 tax liability and plan for 2016.

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