McClanahan & Eaton, LLC

Certified Public Accountants

2014 Year-End Tax Planning for BUSINESSES

This year saw numerous tax developments that affect businesses, many of which deserve special scrutiny for year-end planning in an effort to minimize your 2014 tax bill. While Congressional gridlock has prevented favorable tax provisions, known as the "tax extenders," from being passed, these provisions may not yet be dead. Earlier this year, the Senate Finance Committee passed the Expiring Provisions Improvement Reform and Efficiency (EXPIRE) Act of 2014. Many believe that Congress is just waiting until after the November elections to move forward on this bill. Alternatively, any movement on the bill may not come until 2015. Congress has been known to pass legislation in a tax year after the year to which the legislation applies and has often made the legislation retroactive.

Perhaps the biggest development for businesses in 2014 that doesn't require guesswork, and which may require certain actions before December 31, is the IRS's overhaul of the tangible property rules. These rules affect any business that owns property and may require some modifications to your fixed asset policies so that you can take advantage of, and even comply with, the new rules. Depending on your current policies, refunds may be available for prior years.

Tangible Property Rules

Safe Harbor Election for Expensing Items

One of the more favorable rules in the tangible property regulations is the $5,000 de minimis safe harbor election for expensing an item rather than capitalizing it. In order to take advantage of this election, you must have had written accounting procedures in place at the beginning of the year and have been following those rules for book and tax accounting purposes. If such procedures were in place at the beginning of 2012 or 2013, the election can be made for these years as well but will require amended returns. If you did not have such procedures in place, it's not too late to implement them for 2015, but it must be done by the end of this year.

In addition, you must have an applicable financial statement (AFS) to rely on the $5,000 de minimis safe harbor. If you do not have an AFS, you may rely on the de minimis safe harbor only if the amount paid for property does not exceed $500 per invoice, or per item as substantiated by the invoice. If the cost exceeds $500 per invoice (or item), then you cannot use the de minimis safe harbor. Alternatively, if you do not qualify for the $5,000 safe harbor, you may still be able to deduct amounts over $500 or even over $5,000, if you have a written policy in place, follow it for book purposes, and can prove that it meets materiality thresholds. Various types of statements qualify as an AFS so if you don't

currently have an AFS, we should evaluate whether one of the available options will work for your business.

Finally, the de minimis rule also applies to amounts paid for property having a useful life less than a certain period of time.

Partial Disposition Election

Another favorable item in the final property regulations that may save you some money this year is the partial disposition election. While initially the election could only be made for tax years beginning before January 1, 2014, the IRS recently extended the time frame to any tax year beginning before January 1, 2015. Using this election, you can claim a loss on the disposition of a structural component of a building or on the disposition of a component of any other asset without needing to make a general asset account election. The partial disposition rule also minimizes circumstances in which an original part and any subsequent replacements of the same part must be simultaneously capitalized and depreciated. Thus, for example, if you replaced an engine in a truck, you would generally continue to depreciate the old engine as part of the truck while also depreciating the new engine. Under the partial disposition rule, you can now retire the old engine and recognize a loss on that disposition.

Deductions Available for Rehabilitation of Buildings and other Property

The final rules contain a routine maintenance safe harbor that allows the expensing, rather than capitalizing, of costs of performing certain routine maintenance activities for buildings or the structural components, as well as other property. If you have done any such maintenance this year or plan to do so next year, we should discuss whether the maintenance falls under the "routine" safe harbor and review any changes to maintenance routines going forward to ensure that such costs qualify for immediate expensing.

Deductible Repair and Maintenance Expenses

Under the new tangible property rules, certain repair and maintenance expenses that were previously capitalized can now be expensed. For prior years, this will require amended returns and making certain retroactive elections. Depending on your current tax situation, we should run the numbers to see if amended returns make sense.

Bonus Depreciation

Although bonus depreciation is not currently available for 2014, there is a good possibility it will return. While the likelihood of bonus depreciation being available for 2014 depends on the "tax extenders" bill (i.e., the EXPIRE bill) being passed and signed into law, many politicians have a vested interest in seeing this bill come to fruition. The drawback is that we may not know until late 2014 or even early 2015 whether purchases in 2014 will qualify for the bonus depreciation or what amounts will qualify. On the assumption that the bill passes as written, the 50-percent additional first-year depreciation deduction in effect in 2013 will be extended to qualified property purchased and placed in service before 2016 or before 2017 for certain longer-lived and transportation assets.

Section 179 Deduction

The Section 179 deduction, which allows current expensing of items normally capitalized and depreciated, is also in limbo until the fate of the tax extenders bill is known. Unlike the bonus depreciation, however, there is a limit on the amount that may be expensed and the business must have taxable income to take advantage of this deduction. If the bonus depreciation and Section 179 deduction are passed, we need to evaluate whether it may make more sense to spread these deductions over the life of the property by electing out of these provisions. Currently, for taxable years beginning in 2014 and thereafter, your

business may immediately expense up to $25,000 of Section 179 property annually, with a dollar for dollar phase-out of the maximum deductible amount for purchases in excess of $200,000. If the EXPIRE bill becomes law, it would increase the maximum amount and phase-out threshold in 2014 and 2015 to the levels in effect in 2010 through 2013 ($500,000 and $2 million respectively). The law would also extend the definition of Section 179 property to include computer software and $250,000 of the cost of qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property.

Research Tax Credit

Perhaps one of the most popular provisions in the tax extenders bill on both sides of the aisle is the extension of the tax research credit through 2015. It is almost a given that if any provision gets extended, this one will. Additionally, the EXPIRE bill would allow qualifying startup businesses to claim unused credits against their payroll tax after applying the credit to income tax liability. And, it is worth noting that, in 2014, 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.

S Corporations

In 2014, the IRS loosened the rules relating to S corporation shareholder debt. Under the new rules, it is easier for such debt to give the shareholder basis against which to deduct losses coming from the S corporation. The rules generally eliminated the "actual economic outlay" doctrine replacing it with a clearer "bona fide debt" requirement, and made the changes retroactive. Thus, if a shareholder previously could not deduct losses because the actual economic outlay doctrine wasn't met, amended returns may be in order.

Real Estate Developers

For real estate developers, two court cases this year drew a bright line between the type of contracts that will qualify as home construction contracts eligible for the completed contract method and those that will not. As a result of the decisions in these cases, one pro-taxpayer and one pro-IRS, it is worth taking a second look at whether the method being used to account for income from such contracts can be reported under the completed contract method.

Affordable Care Act ('Obamacare')

The Affordable Care Act includes several provisions that may affect you as an employer, including the shared responsibility provisions, also known as the "employer mandate." Under the employer mandate, which is effective January 1, 2015, a penalty is imposed on certain large employers that do not offer health insurance coverage, offer health insurance coverage that is unaffordable, or offer health insurance coverage that consists of a plan under which the plan's share of the total allowed cost of benefits is less than 60 percent.

It is important to note that this provision only applies to an employer who employed an average of at least 50 full-time employees on business days in the preceding calendar year. Additionally, subject to certain requirements, no employer shared responsibility payments will apply during 2015 for employers with fewer than 100 full-time employees.

The penalty is assessed for any month in which a full-time employee is certified to the employer as having purchased health insurance through an Exchange with respect to which a premium tax credit or cost-sharing reduction is allowed or paid to the employee. However, it is worth noting that currently there are multiple ongoing court battles over whether insurance purchased on a federally established Exchange qualifies for the subsidies, which

then triggers the tax on the employer. The issue will most likely not be resolved until sometime later next year.

Small Employer Credit

With respect to health insurance, your business may be eligible for a credit for contributions to purchase health insurance for employees. The amount of the credit increased this year to 50 percent (35 percent for tax-exempt organizations) of premiums paid. The tax credit is subject to a reduction if you have more than 10 full-time employees or if average annual full-time employee wages exceed $25,000.

Mass Transit Benefits

If you subsidize your employee's commuting expenses, there is an item in the EXPIRE Bill which could affect your business. The provision would increase, for 2014 and 2015, the monthly exclusion from income for employer-provided transit and vanpool benefits from $130 to $250, so that it would be the same as the exclusion for employer-provided parking benefits. In order for the extension to be effective retroactive to January 1, 2014, employers may reimburse expenses incurred by employees before enactment for vanpool and transit benefits on a tax-free basis to the extent the expenses exceed $130 per month and are not more than $250. The Bill also modifies the definition of qualified bicycle commuting reimbursement to include expenses associated with the use of a bike sharing program for two years. Thus, the benefits that are excludible from income will not be includible in the employee's income on Form W-2 and are deductible by employers as fringe benefits.

Please do not hesitate to call me if you have any questions or if you would like to set up an appointment to estimate your business's tax liability for the year, review policies surrounding the acquisition and disposition of fixed assets, discuss options available for reducing your business's taxes, and to address any questions you may have.

Sincerely,

MCCLANAHAN & EATON
CERTIFIED PUBLIC ACCOUNTANTS