Carmody Meach & Choo LLP
Certified Public Accountants

2 North Lake Avenue Suite 830
Pasadena, CA 91101
(626) 440-1077
http://www.cmccpa.net

Roger Carmody CPA
roger@cmccpa.net, ext 104

Lee Meach CPA
lee@cmccpa.net, ext 103

Wayne Choo CPA
waynec@cmccpa.net, ext 105

December 2014

2014 Year-End Tax Planning for Businesses

Dear Client:

In recent years, end of year tax planning for businesses has been complicated by uncertainty over the availability of many tax incentives. The 2014 year-end is no different. In the early hours of January 1, 2013, the Senate passed the American Taxpayer Relief Act of 2012, which permanently extended the so-called Bush-era tax cuts. However, other popular provisions were only extended through 2013. Therefore, 2014 tax strategies include concerns over the fate of the expired provisions. President Obama, the chairs of the House and Senate tax writing committees, and individual lawmakers all made tax reform proposals in 2014. The proposals ranged from comprehensive tax reform to more piece-meal approaches. However, any progress on legislation is stalled until after the elections and possibly into the beginning of 2015.

In the meantime, federal tax developments affecting businesses in 2014 include significant transition relief for employer shared responsibility for both medium-sized employers (50-99 full-time employees) and larger employers (100 or more full-time employees); and health insurance reporting regulations that allow combined reporting by applicable large employers reporting both as an applicable large employer and as the provider of a self-insured plan. Also, the IRS has released the automatic accounting method change procedures relating to Modified Accelerated Cost Recovery System (MACRS) under final, temporary, and proposed regulations that were issued in conjunction with the IRS tangible property regulations, as well as, final regulations related to the dispositions of MACRS property and accounting for property in MACRS general asset accounts (GAAs). In addition, guidance continues to be released on employee benefits and same-sex marriages following the Windsor decision.

These various factors illustrate the need to continuously adapt tax strategies for what is known and what might be. This letter provides highlights for 2014 year-end tax planning for businesses in the context of the uncertainty of additional extensions on expired provisions, the implementation of requirements under health care reform and final repair regulations, and continued IRS guidance on same-sex marriages.

Expired Provisions for possible extension

Bonus Depreciation and Code Sec. 179 Expense Deduction

Bonus Depreciation

The 2012 Taxpayer Relief Act extended the additional 50 percent bonus depreciation allowance for one year to apply to qualifying property acquired and placed in service before January 1, 2014 (or before January 1, 2015, in the case of property with a longer production period and certain noncommercial aircraft). There was no limit on the total amount of bonus depreciation that may be claimed.

Qualified property. Property that is eligible for bonus depreciation must be new property (i.e., property the original use of which begins with the taxpayer) that is:

1. tangible property
2. that is depreciable under MACRS, with a recovery period not exceeding 20 years;
3. purchased computer software;
4. water utility property;
5. or qualified leasehold improvement property.

The fifty-percent bonus depreciation deduction is taken before regular depreciation is computed for the year property is placed in service. As with any accelerated depreciation, however, a large current depreciation deduction results in smaller future deductions.

Vehicles. For passenger automobiles placed in service in 2013, the deduction limitations for the first three years are $3,160 ($11,160 if bonus depreciation applies), $5,100, and $3,050, respectively, and $1,875 for each succeeding year. For trucks and vans first placed in service in 2013, the deduction limitations for the first three years are $3,360 ($11,360 if bonus depreciation applies), $5,400, and $3,250, respectively, and $1,975 for each succeeding year.

For passenger automobiles placed in service in 2014 the deduction limitations for the first three years are $3,160, $5,100, and $3,050, respectively, and $1,875 for each succeeding year. For trucks and vans first placed in service in 2014, the depreciation limitations for the first three years are $3,460, $5,500, and $3,350, respectively, and $1,975 for each succeeding year.

Code Sec. 179 Expense Deduction

For tax years beginning in 2012 and 2013, the 2012 Taxpayer Relief Act increased the Code Sec 179 dollar limit to $500,000 and the investment limit to $2 million. For purposes of Code Sec. 179, qualifying property is depreciable tangible property that is purchased for use in an active trade or business. This includes off-the-shelf computer software placed in service before 2014.

A taxpayer may also elect to treat qualified real property as Code Sec. 179 property. However, only $250,000 of the cost of qualified real property may be expensed. Qualified real property generally consists of qualified leasehold improvements, qualified retail improvement property, and qualified restaurant improvement property.

Planning Tips for Bonus Depreciation and Code Sec. 179 Expense Deduction

The expense deduction allowed by Code Sec. 179 is independent of the bonus depreciation allowance. The Code Sec. 179 deduction is computed first, and the taxpayer's basis in the qualifying property is reduced by the amount of that deduction. Any bonus depreciation deduction is computed on the remaining basis in the property. Many times there are no advantages between choosing Code Sec. 179 expensing or bonus depreciation. For example, both deductions are allowed in full for AMT purposes. However, certain important distinctions do exist.

Unlike the Code Sec. 179 allowance, there is no taxable income or investment income limitation on the amount of additional first year depreciation claimed. However, like the Code Sec. 179 deduction, the entire additional first year depreciation allowance may be claimed in a short tax year. The Code Sec. 179 allowance may only be claimed on property that is used more than 50 percent for business purposes. On the other hand, the additional first year depreciation allowance applies to eligible property whether it is used for trade or business purposes or investment/production of income purposes.

Used and new property section 1245 property qualifies for the Code Sec. 179 expense allowance without regard to the recovery period. Only new property with an MACRS recovery period of 20 years or less qualifies for additional first year depreciation. Therefore, a taxpayer should generally first expense property that does not qualify for bonus depreciation.

Both bonus depreciation and the increases in the Code Sec. 179 expense deduction and investment limits were meant to provide temporary incentives for business investment and expired at the end of 2013. Unless there is further legislative action, the deduction limit is set at $25,000, and the investment limitation is set at $200,000 for tax years beginning in 2014.

Tax Credits

Research Credit. The 2012 Taxpayer Relief Act extended the research credit to apply to any amounts paid or incurred for qualified research and experimentation before January 1, 2014. However, for purposes of the orphan drug credit, the research credit is deemed to remain in effect for periods after December 31, 2013.

Work Opportunity Credit. The work opportunity credit for all targeted groups was extended through December 31, 2013. Therefore, the credit applied with respect to wages paid to persons who begin work for the employer before January 1, 2014.

Targeted groups include, among others:

1. qualified individuals in families receiving certain government benefits;
2. qualified individuals who receive supplemental social security income or long-term family assistance;
3. veterans who are members of families receiving food stamps, who have service-connected disabilities, or who are unemployed;
4. qualified summer youth employees; and
5. ex-felons hired no more than one year after the later of their conviction or release from prison.

Differential Wage Credit for Activated Military Reservists. Eligible small employers can claim a tax credit for up to 20 percent of the military differential wage payments it makes to activated military reservists through December 31, 2013.

Recognition Period for S Corporation Built-in Gains

For tax years beginning in 2012 and 2013, for purposes of computing the built-in gains tax, the recognition period is the five-year period beginning with the first day of the first tax year for which the corporation was an S corporation.

The built-in gains tax can be triggered by downsizing or other business survival decisions, including the disposal of unused assets to raise needed cash. Consequently, the relief provided by the shorter recognition period was valuable for small family or privately-owned businesses.

Small Business Stock

The 100-percent exclusion allowed for gain on the sale or exchange of qualified small business stock under Code Section 1202 was extended for stock acquired before January 1, 2014, and then held for more than five years by noncorporate taxpayers. Preferential AMT treatment also applies. The exclusion under Code Section 1202 after 2013 reverts to 50 percent.

Some Other Provisions that Expired at 2013 Year-End

1. Enhanced deduction for charitable contributions of food inventory;
2. Tax incentives for empowerment zones;
3. Indian employment credit;
4. Low-income tax credits for non-federally subsidized new buildings;
5. Low-income housing tax credit treatment of military housing allowances;
6. Adjusted-basis reduction of stock after S corporation charitable donation of property.

Employer mandate shared responsibility rules

Beginning in 2015, applicable large employers are subject to the employer mandate. Under these rules an employer that has any full-time employees that claim a health insurance premium tax credit may be subject to a shared responsibility assessment by the IRS. If the employer does not offer minimum essential health coverage to at least 95 percent of its employees and their dependents, the employer's assessed payment is based on the total number of its full-time employees (minus 30). If it does offer such coverage, the assessed payment amount is based solely on the number of employees who claimed a premium tax credit whether because they were offered no coverage or because the coverage offered to them was unaffordable or did not meet minimum value standards. Safe harbors are available both for counting full-time employees, and for affordable coverage.

To be an applicable large employer an employer must employ at least 50 full-time employees or a combination of full-time and part-time employees that equals at least 50. For example, 40 full-time employees employed 30 or more hours per week on average plus 20 half-time employees employed 15 hours per week on average are equivalent to 50 full-time employees. Employers determine each year, based on their current number of employees, whether they are considered a large employer for the next year. For example, applicable large employer status for 2015 is determined based on the number of full-time employees the employer averages in 2014.

Employers average their number of employees across the months in the year to see whether they meet the large employer threshold. The averaging can take account of fluctuations that many employers may experience in their work force across the year.

Because employers will be performing this calculation for the first time to determine their status for 2015, there is a transition rule intended to make this first calculation easier.

Reporting requirements. Beginning in 2015 (postponed from 2014), certain large employers are required to report to the IRS whether they offer full time employees and their dependents the opportunity to enroll in minimum essential coverage under an eligible employer sponsored plan and provide details regarding the coverage offered and other required information.

An applicable large employer must file information returns with the IRS and furnish statements to employees beginning in 2016, to report information about its offers of health coverage to its full-time employees for calendar year 2015. However, in preparation for the application of the employer shared responsibility provisions beginning in 2015, employers and other affected entities may comply voluntarily for 2014 with the information reporting provisions and are encouraged to maintain or expand coverage in 2014. Returns filed voluntarily will have no impact on the employer's tax liability.

Revised Repair/Capitalization Rules

The IRS recently issued long-awaited comprehensive final rules on the treatment of payments to acquire, produce or improve tangible property. Starting January 1, 2014, businesses must use these new rules in determining whether they can deduct their costs as repairs under Code Sec. 162(a) or must capitalize the costs, to be recovered over a period of years under Code Sec. 263(a).

Generally, the final regulations apply to tax years beginning on or after January 1, 2014. However, taxpayers may choose to apply them to tax years beginning on or after January 1, 2012. Taxpayers also have the option to use the 2011 temporary regulations for tax years beginning on or after January 1, 2012 and before January 1, 2014. Because the final regulations went into effect in 2014, taxpayers were advised to revise their written accounting procedures to comply with the expensing limits by the end of 2013 if they wanted to use the de minimis safe harbor, and in many instances, they must also have changed their method of accounting.

SAME-SEX MARRIAGES

The IRS issued guidance stating that same-sex couples who are legally married in jurisdictions that recognize their marriages will be treated as married for federal tax purposes regardless of whether or not their current place of residence recognizes same-sex marriage.

IRS guidance further explains that a cafeteria plan may treat a participant who was married to a same-sex spouse as of the date of the Windsor decision (June 26, 2013) as if the participant experienced a change in legal marital status. Accordingly, a cafeteria plan may permit such a participant to revoke an existing election and make a new election in a manner consistent with the change in legal marital status. A cafeteria plan may also permit a participant who marries a same-sex spouse after June 26, 2013, to make a mid-year election change due to a change in legal marital status.

In addition, a cafeteria plan may permit a participant's FSA, including a health, dependent care, or adoption assistance FSA, to reimburse covered expenses of the participant's same-sex spouse or the same-sex spouse's dependent that were incurred during a period beginning on a date that is no earlier than (a) the beginning of the cafeteria plan year that includes the date of the Windsor decision or (b) the date of marriage, if later.

For this purpose, the same-sex spouse may be treated as covered by the FSA (even if the participant had initially elected coverage under a self-only FSA) during that period. For example, a cafeteria plan with a calendar year plan year may permit a participant's FSA to reimburse covered expenses of the participant's same-sex spouse or the same-sex spouse's dependent that were incurred during a period beginning on any date that is on or after January 1, 2013 (or the participant's date of marriage if later).

To the extent that the cafeteria plan sponsor chooses to permit election changes that were not previously provided for in the written plan document, the cafeteria plan must be amended to permit such election changes on or before the last day of the first plan year beginning on or after December 16, 2013. Such an amendment may be effective retroactively to the first day of the plan year including December 16, 2013, provided that the cafeteria plan operates in accordance with the guidance under the IRS guidance.

Pass-through Issues

Many business operations are not taxed on the entity level as corporations but, instead, pass through taxable profits and losses to their unincorporated owners or to their S corporation shareholders. Starting in 2013, these owners faced new year-end planning challenges in the form of a higher individual tax rate of 39.6 percent and additional surtaxes on passive income by way of the net investment income surtax of 3.8 percent and the Additional Medicare Tax of 0.9 percent on compensation, both aimed at the “higher-income” taxpayers. Deferring some of this income, or harvesting losses to offset some of the income, are traditional year-end planning techniques that take on added value for the 2014 year-end tax year.

Business tax planning involves, not only economic planning for that year, but also making wise tax decisions that will benefit the business for years to come. Tax-saving strategies must take into account short-term and long-term goals so that decisions made for the current tax year also represent sound tax decisions in following years. Often, because business planning opportunities must be viewed in conjunction with personal tax planning, a taxpayer should also consider planning tips affecting their individual return and investment considerations when making business decisions.

Please call our office to discuss the 2014 tax planning strategies that may apply to you.

Sincerely yours,
Carmody Meach & Choo LLP
Certified Public Accountants