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YEAR-END TAX PLANNING

DEPRECIATION BREAKS TAKE CENTER SPOTLIGHT

As the year winds down, your company's tax planning should ramp up. Now's a good time to start projecting your tax liability and determine what specific steps you can take to minimize it while maximizing your cash flow. This year, there are no earth-shattering changes to the Internal Revenue Code. But there are still plenty of potentially beneficial moves to consider.

Taking the center spotlight in 2016 are depreciation-related tax breaks. The passage of the Protecting Americans from Tax Hikes Act (the PATH Act) in late 2015 gave these a substantial boost. So, if buying assets or improving your facilities makes sound business sense, you may be able to enjoy some savings on your tax bill.

Expense to save

Most discussions of depreciation-related tax breaks begin with Section 179. It allows companies to "expense" the cost of certain tangible property acquired and put into service during the tax year. In other words, you can deduct the cost immediately, instead of deducting the depreciation gradually over time.

Not surprisingly, there are limits on how much you can deduct under Sec. 179. Currently, a business can expense up to $500,000 in qualified new or used assets, but with a dollar-for-dollar phaseout once the taxpayer hits and exceeds $2 million in asset acquisitions. These amounts are particularly valuable in light of what could have happened absent the PATH Act. Namely, the expensing limit and phaseout would have reverted to $25,000 and $200,000, respectively.

In addition, the act made permanent the ability to apply Sec. 179 expensing to qualified real property such as heating and air-conditioning units. Also, off-the-shelf computer software can be expensed. Just bear in mind that you can use Sec. 179 expensing only to offset net income; you can't use it to reduce income below $0 to create a net loss.

As is the case with many tax-related decisions, timing is everything. If you need to make an asset purchase, you may want to do so before year end so you can expense the cost under Sec. 179. On the other hand, if you're already at or near the allowable ceiling, you might be better off waiting until January so you can take the deduction for the 2017 tax year.

Or grab a bonus

Another welcome change wrought by the PATH Act was the extension of bonus depreciation. This tax break allows businesses to recover the cost of depreciable assets faster by deducting an extra share of depreciation during the first year they're placed in service. But, it's important to note that bonus depreciation applies only to qualified *new* tangible assets with a recovery period of 20 years or less. This typically includes office furniture and equipment, and off-the-shelf computer software.

The operative word here, however, is "extended." Right now, bonus depreciation will exist only through 2019, and with diminishing allowances after 2017. Allowable bonus depreciation remains at 50% for this year and next, and then drops to 40% in 2018 and 30% for 2019.

This provision also holds an important key for companies at risk for incurring liability under the alternative minimum tax (AMT). That is, such businesses may claim unused AMT credits in place of bonus depreciation. And the amount of unused AMT credits that can be claimed increases in 2016.

Weigh the pros and cons of Sec. 179 expensing vs. bonus depreciation carefully. Sec. 179 may yield higher benefits because it allows you to claim 100% of an asset's cost, whether the item is new or used. On the other hand, bonus depreciation isn't subject to asset purchase limits or net income requirements, and it can generate a net operating loss.

Work Opportunity credit offers an … opportunity

It may be getting a bit late in the year to make major hiring decisions. But there's a good reason to still strongly consider adding employees in the near future: the Work Opportunity tax credit. This break was extended under the Protecting Americans from Tax Hikes Act (the PATH Act) of 2015. But it wasn't extended for only a year or two — it's now in place through 2019, giving you a large time frame in which to consider staffing moves.

The Work Opportunity credit benefits employers that hire individuals who are members of certain "target groups," including:

- ✓ Unemployed veterans (including disabled veterans),
- ✓ Designated community residents (living in Empowerment Zones or Rural Renewal Counties),
- ✓ Food stamp recipients,
- ✓ Vocational rehabilitation referred individuals, and
- ✓ Ex-felons.

The PATH Act also expands the credit beginning in 2016 to apply to employers that hire qualified individuals who have been unemployed for 27 weeks or more.

The amount of the tax credit depends on the target group of the individual hired, the wages paid to that individual and the number of hours that individual worked during the first year of employment. The maximum tax credit that can be earned for each member of a target group is generally $2,400 per adult employee. But the credit can be as high as $9,600 per qualified veteran.

There's no limit on how many eligible individuals you can hire. But you must obtain certification that an employee is a member of a target group from the appropriate State Workforce Agency before you can claim the credit. The certification must be requested within 28 days after the employee begins work. Other restrictions and requirements apply.

Improve your facilities

If your company is considering improvements to its physical location, there's another depreciation-related tax break to consider. And it, too, was impacted by the PATH Act. Now permanently extended is the 15-year straight-line cost recovery period for qualified:

- ✓ Restaurant property,
- ✓ Leasehold improvements (alterations in a building to suit the needs of a particular tenant), and
- ✓ Retail-improvement property. The provision exempts these expenditures from the normal 39-year depreciation period.

This has been especially welcome news for restaurants and retailers, which typically remodel every five to seven years. If eligible, your business may first apply Sec. 179 expensing and then enjoy this accelerated depreciation on qualified expenses in excess of the applicable Sec. 179 limit.

Start here

To be clear, depreciation-related breaks aren't the "be all, end all" of year-end tax planning. But they are a good place to start given their relative value at the moment. Work closely with your CPA to determine which tax-saving strategies would benefit your company both this year and next. ❐

RESPECTING THE RISKS OF A 401(k) LOAN

Many of today's employers offer 401(k) plans — and have for some time. As such, these accounts have grown substantially over time for a large number of employees. If you're one of them, you may be tempted to take out a 401(k) loan.

It's understandable. Even in moderately good economic times, a large sum of money can beckon when thoughts of a life-changing trip or prized material possession (such as a new car) come to mind. There's no harm in thinking; just be sure to respect the sizable risks of making such a move.

Study the terms

Taking out a 401(k) loan is generally easier than a conventional bank loan. But there are still basic rules involved. First, you'll have to check whether your plan even allows loans. Most do, but that's no guarantee.

If your 401(k) does allow loans, the maximum amount you can borrow is 50% of your vested balance up to $50,000. And the terms of your loan can't go more than five years unless you're using the money to buy a home (if it will be your "principal residence"). In the case of a home purchase, you can have up to 30 years to pay back the money.

To officially execute the loan, you'll need to sign a promissory note as well as a form authorizing a payroll deduction repayment plan. In addition, your employer will likely prepare an amortization schedule and provide a list of loan terms that includes the loan amount, your repayment terms, the loan's length and the interest rate.

Be prepared to pay

Should you fail to abide by the terms of your 401(k) loan or the statutory requirements governing these transactions, the IRS will treat the amount you borrowed as a "deemed distribution" — a taxable event. That means you'll be taxed on the loan amount at your current income tax rate.

The good news is that your employer may have built a "cure period" into its loan program that enables borrowers to fix their mistakes before taking a big tax hit. The length of a cure period, however, can't exceed one calendar quarter following the quarter in which the loan violation took place. So check with your benefits rep about this.

Indeed, employers can build many stipulations into their 401(k) plans that you should know about before deciding to pull the trigger on such a loan. Your current employer may not handle it the same way a previous one did.

Should you fail to abide by the terms of your 401(k) loan or the statutory requirements governing these transactions, the IRS will treat the amount you borrowed as a "deemed distribution" (a taxable event).

Also bear in mind that you may have more to fear than taxes. If you're younger than 59½ and you fail to repay your loan within the allotted period, you may face a 10% early withdrawal penalty. And, yes, that's in addition to any income tax liability.

Know your emergency options

In some limited situations, you may not need to take out a 401(k) loan at all — you could be eligible to make a "hardship withdrawal." Your employer's plan may, for instance, permit such withdrawals for medical care, college tuition, funerals and home-related expenses to avoid eviction or foreclosure.

Naturally, hardship withdrawals aren't necessarily easy to qualify for. Expect to be asked for proof that you've gone through any of your available resources. Plus, your withdrawal amounts will still be subject to your current income tax rate and, aside from some medical expenses, you'll have to pay that 10% early withdrawal penalty (again assuming you're under age 59½).

So what's the advantage of a hardship withdrawal? You don't need to pay back the money. Just bear in mind that, along with the taxes you pay currently, you're giving up future tax-deferred earnings on the withdrawal amount.

Think it through

A 401(k) account is an important asset for everyone who has one. It's well worth your time to monitor your balance and know your investments. A loan, however, is a risky proposition. Make sure you think the idea through and discuss it with your CPA. ❒

Moneylines: News briefs for businesses

New overtime rule warrants careful examination. Earlier this year, the Department of Labor released a final rule that dramatically changes how employers must determine which executive, administrative and professional employees are entitled to overtime pay under the Fair Labor Standards Act. The details are complex, but many believe the rule will make it more difficult to classify employees as exempt from overtime requirements. If your company typically pays overtime to certain staff members, consult with your payroll advisor to carefully examine the new rule to ensure you'll stay in compliance with all applicable regulations.

Identify the factors that could break up your supply chain. Disruptions to your supply chain could slow productivity and hurt profitability. A study released earlier this year by supply chain association APICS and Michigan State University revealed some of the top concerns of managers in this area. Worries included capacity and resource availability, intense competition for talent, and exploding complexity. Every organization should pinpoint the greatest threats to its supply chain and take action to reduce the chances that these links could falter.

Could your vendors be putting your cybersecurity at risk? When you picture threats to your company's networks, you may envision unscrupulous employees and faceless external hackers. But a May 2016 report by the Ponemon Institute found that 70% of respondents (employees involved in risk management) believed third-party (that is, vendor) risks to their organizations are significantly increasing. The study recommended communicating ethical values across the enterprise, setting a positive tone from the top down and creating a formal vendor risk management program.

HOUSE BUYERS FIND THAT TAX BREAKS BEGIN AT HOME

Monty and Felice had been apartment dwellers for a long time. Even after they married, the couple found the flexibility and affordability of renting preferable to the commitment of buying. But their growing family eventually drove them to buy a house.

The home they purchased was a bit of a fixer-upper. As they grappled with the financial challenges of homeownership, the couple sat down with their CPA. They knew they might be able to get a tax break for mortgage interest and real estate taxes. But their CPA explained that their new home could save them tax dollars in a couple of other ways.

Nonbusiness energy property

Just last year, their CPA explained, Congress passed the Protecting Americans from Tax Hikes Act of 2015 (the PATH Act). The act extended a variety of tax breaks for individuals.

"Because your new house needs some work, you should look into energy-efficient upgrades," the accountant recommended. Indeed, the PATH Act extended through the 2016 tax year the credit for purchases of residential "energy property." This includes items such as:

- ✓ Environmentally friendly insulation,
- ✓ Energy-efficient exterior windows and doors,
- ✓ New high-efficiency heating and air conditioning systems, and
- ✓ High-efficiency water heaters and stoves that burn biomass fuel.

The provision allows a credit of 10% of expenditures for qualified energy improvements, the advisor noted, up to a lifetime limit of $500. So, because Monty and Felice had been thinking about investing in such upgrades anyway, they now had a strong incentive to start contracting out at least some of the work immediately so it could be completed before year end.

Mortgage-related tax breaks

"There's a second aspect of the PATH Act that should also interest you," their CPA continued. "The law extended some important and potentially beneficial mortgage-related tax breaks."

Under the act, taxpayers can treat qualified mortgage insurance premiums as interest for purposes of the mortgage interest deduction through the 2016 tax year. The deduction phases out, however, for taxpayers with adjusted gross incomes of $100,000 to $110,000. So the couple may not qualify.

Although mortgage loan forgiveness probably isn't something Monty and Felice are worried about now, their CPA still noted that the act extended through 2016 the exclusion from gross income for mortgage loan forgiveness. It also modified the exclusion to apply to mortgage forgiveness that occurs in 2017 as long as it's granted pursuant to a written agreement entered into in 2016.

Good timing

There's no doubt, their CPA concluded, that owning a home can bring a myriad of surprises — many of them unpleasant. But recent tax law changes made the couple's timing quite good. ❒

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