Businesses Tax Considerations – Year End Tax Planning 2013

This year end provides unique opportunities for virtually every business to reassess their business plan with an eye toward maximizing tax savings for the 2013 tax year and forward, for 2014 and beyond. This year, shareholders and other business owners face a new landscape of tax rates for "higher income" individuals in the form of a 39.6 percent income tax rate, a 20 percent maximum tax rate on capital gains and dividends, a 3.8 percent net investment income tax, and a 0.9 percent Medicare compensation surtax for the first time in 2013.

New as well are requirements and opportunities surrounding the tax treatment of repairs, improvements, acquisition costs and other common business expenses. Further, some of the usual tax breaks for businesses may be coming to an end with 2013, if Congress does not renew them. 2013 may provide the last chance for businesses to take advantage of bonus depreciation, enhanced "section 179" expensing, and a sunsetting work opportunity credit.

Finally, although the "employer mandate" under the new health care reform law was recently postponed from 2014 to 2015, now is not too early to start planning to comply with rules that will be based on employee makeup starting January 1, 2014.

Bonus Depreciation

Bonus depreciation is scheduled to end after 2013 if not renewed by Congress. Additional 50-percent bonus depreciation was extended by the American Taxpayer Relief Act of 2012 (ATRA, signed into law on January 2, 2013) for one-year only and applies to qualifying property placed in service before January 1, 2014. In the case of property with a longer production period and certain noncommercial aircraft, the extension also applies to property acquired before January 1, 2014 and placed in service before January 1, 2015.

Unlike regular depreciation, under which half- or quarter-year conventions may be required, a taxpayer is entitled to the full, 50-percent bonus depreciation irrespective of when during the year the asset is purchased. Year-end placed-in-service strategies therefore can provide an almost immediate "cash discount" from qualifying purchases, even when factoring in the cost of business loans to finance a portion of those purchases.

Bonus depreciation is available only for new property (i.e., property whose original use begins with the taxpayer) depreciable under MACRS that (a) has a recovery period of 20 years or less, (b) is MACRS water utility property, (c) is computer software depreciable over three out of bonus depreciation with respect to any class of property placed in service during the tax year. Although this election may be factored into a year-end strategy, a final decision on making it is not required until a return is filed next year.

*Luxury car depreciation caps***.** Along with the sunset of general bonus depreciation, the additional $8,000 first-year depreciation cap for passenger automobiles to account for bonus depreciation will no longer be available for vehicles acquired and placed in service after December 31, 2013. For some businesses, this may provide an added incentive to purchase and place into service) a vehicle before year end 2013.

Code Section 179 expensing

An enhanced section 179 expense deduction is available until 2014 for taxpayers (other than estates, trusts or certain noncorporate lessors) that elect to treat the cost of qualifying property (so called section 179 property) as an expense rather than a capital expenditure. The current section 179 dollar cap for 2013 is $500,000. For tax years beginning after 2013, that dollar limit is officially scheduled to plunge to $25,000 unless otherwise extended by Congress. For tax years beginning in 2013, the overall investment limitation is $2 million. That level is also scheduled to fall to $200,000 in 2014.

A taxpayer will receive the greatest benefit from Code Section 179 by expensing property that does not qualify for bonus depreciation (e.g., used property) and property with a long MACRS depreciation period. For example, given the choice between expensing an item of MACRS five-year property and an item of MACRS 15-year property, the 15-year property should be expensed since it takes 10 additional tax years to recover its cost through annual depreciation deductions.

Qualifying property. Section 179 property is generally defined as new or used depreciable tangible section 1245 property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software is also included for 2013, as is qualified real property (up to $250,000). Both of these latter types of property will no longer qualify for section 179 expensing at all after 2013, even at the lower $25,000 ceiling, making strategies that take advantage of them in 2013 particularly critical.

Qualified real property. After four years, the section 179 expensing allowance for qualified real property is scheduled to end for property placed in service after 2013. Qualified real property for expensing purposes includes qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property. Any amount of expensing for qualified real property disallowed by reason of the taxable income limitation, however, may not be carried forward to a tax year that begins after 2013 and such amount must be recovered through regular depreciation deductions only.

Work Opportunity Credit

The Work Opportunity Credit, which has been extended at various times in various iterations, ends on December 31, 2013. To qualify for the credit, an employer must hire members of certain targeted groups and have those individuals start work before January 1, 2014. Targeted groups, as listed in Code Sec. 51, include qualified individuals in families receiving certain government benefits, including Title IV-A social security benefits (aid for dependent children) or food stamps; qualified individuals who receive supplemental social security income or long-term family assistance; veterans who are members of families receiving food stamps, who have service-connected disabilities, or who are unemployed; designated community residents; vocational rehabilitation referrals certified to have physical or mental disabilities; and others.

Employers are eligible for the work opportunity credit to the extent that qualifying employees are certified as members of a target group by a designated local agency (DLA). On or before the day the employee begins work, the employer must receive a written certificate from the designated local agency indicating that the employee is a member of a specific targeted group. Employers can use Form 8850. Pre-Screening Notice and Certification

Request for the Work Opportunity Credit, to obtain the certification. The IRS allows forms to be submitted electronically to DLAs with receipt systems that meet IRS standards. Alternatively, as part of a written certification request, the employer may complete a prescreening notice on or before the day the employee is offered a job, and submit the notice to the designated local agency within 28 days after the employee commences work.

The credit is generally equal to 40 percent of the qualified worker's first-year wages up to $6,000 ($3,000 for summer youths and $12,000, $14,000, or $24,000 for certain qualified veterans). For long-term family aid recipients, the credit is equal to 40 percent of the first $10,000 in qualified first year wages and 50 percent of the first $10,000 of qualified second-year wages.

Small Business Stock

ATRA ’12 extended the 100-percent exclusion allowed for gain on the sale or exchange of qualified small business stock under Code Section 1202. The stock must be 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 a 50 percent exclusion.

Eligible gain from the disposition of qualified stock of any single issuer is subject to a cumulative limit for any given tax year equal to the greater of: (1) $10 million ($5 million for married taxpayers filing separately), reduced by the total amount of eligible gain taken in prior tax years; or (2) 10 times the taxpayer's adjusted basis in all qualified stock of a corporation disposed of during the tax year.

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). Businesses will benefit if certain procedures for treating expenses are put into place by January 1, 2014. Some businesses will be better off if they start applying the new rules retroactively to the 2012 and 2013 tax years. Many of these decisions require advance planning.

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 face 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 2013 year-end tax year.

Next Step

Based upon all that is new and all that may be expiring in 2013, many businesses can benefit from a fresh assessment of how year-end tax planning can help reduce their overall tax liability for both 2013 and 2014. Please our office if you have any questions regarding the opportunities presented in this letter or would like a more customized analysis of steps your business may take at year-end 2013 to minimize taxes and maximize overall tax opportunities.