2017 YEAR-END INCOME TAX PLANNING FOR BUSINESSES

INTRODUCTION

It's that time of year when businesses should start developing year-end planning strategies. Unfortunately, year-end planning this year is proving to be more challenging than ever because, for the first time in over 30 years, we are facing the real possibility that Congress could pass major tax reform legislation - possibly by the end of this year. As we completed this letter, the House Ways and Means Committee had recently released (on November 2, 2017) the initial draft of its Tax Reform Bill which, if enacted, would make significant changes impacting corporate and non-corporate businesses. For example, if enacted, this proposed legislation would: Reduce tax rates for C corporations and for the individual owners of proprietorships, partnerships and S corporations; Allow an up-front write-off of business assets except for land and buildings; Either curtail or eliminate altogether certain targeted deductions and credits currently available to businesses; and, Limit the interest deduction for larger businesses. We have included in this letter a general overview of key provisions in this proposed legislation.

Caution! The status of this legislation is fluid. It is not possible to predict with precision what changes will be included in any *"final"* tax bill, when it will be passed, or even whether final tax reform legislation will be passed at all. Moreover, many of the changes currently being discussed could be modified or even dropped altogether in the final legislation. **Planning Alert!** We are ***closely monitoring this proposed legislation. Feel free to call our firm for a status report.***

Notwithstanding the uncertainty of tax reform, this letter outlines certain *traditional* year-end tax planning strategies that we think businesses should consider. This letter also highlights *new* tax planning opportunities that may be available due to recent Court cases, new IRS regulations, and new IRS rulings. However, due to the uncertainty of tax reform, we believe the best approach is to delay the implementation of tax-savings strategies as long as possible - but be ***prepared to act quickly near the end of 2017*****!**

Caution! Although this letter contains many planning ideas, you cannot properly evaluate a particular planning strategy without calculating the overall tax liability for the business and its owners (including the alternative minimum tax) with and without the strategy. In addition, this letter contains ideas for Federal income tax planning only. ***State income tax issues are not addressed.*** However, you should consider the state income tax impact of a particular planning strategy. We recommend that ***you call our firm before implementing any tax planning technique*** discussed in this letter, or if you need more information.

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PROPOSED TAX REFORM LEGISLATION RELEASED NOVEMBER 2, 2017 – GENERAL OVERVIEW

As discussed previously, on ***November 2, 2017,*** the House Ways and Means Committee released its initial proposed tax reform bill entitled ***"The Tax Cuts And Jobs Act of 2017"*** (the ***"Act"***). We highlight below selected provisions in the ***Act*** that we believe, if enacted, could have a significant impact on ***Corporate and Non-Corporate Business*** taxpayers. **Caution!** Over the upcoming weeks, there will likely be changes to this proposed tax legislation as it works its way through Congress that would impact businesses that we do not discuss below. We closely monitor proposed tax legislation, so feel free to call our firm if you have questions about proposals not discussed below, you need more information on a specific proposal, or you simply need a status report.

Unless stated otherwise, the proposals listed below generally *would not be effective until 2018*!

Lower Tax Rates And Repeal Of AMT For Regular Corporations. The *Act* would lower the regular corporate income tax rate to a fixed rate of 20% (down from the current highest corporate rate of 35%). Personal service corporations would be subject to a flat rate of 25%. The corporate *"Alternative Minimum Tax"* (AMT) would be repealed.

Lower Taxes On "Small Businesses" Taxed As Pass-Through Entities. The *Act* contains a provision designed to ensure that qualified business income passing through and reported on an individual owner's tax return will not be taxed at a rate higher than 25% (otherwise this business income could be taxed as high as 39.6% under the proposed individual income tax rate schedules). The provision contains an anti-abuse rule that would make it difficult for most personal service businesses to obtain the benefit of the 25% cap. The personal-service businesses targeted by this anti-abuse rule, include businesses involved in the performance of services in the fields of: health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, and others.

Enhanced First-Year 168(k) Bonus Depreciation. For qualifying property placed-in-service ***after September 27, 2017*** (and before January 1, 2023), the *Act* would enhance the existing *First-Year* ***168(k) Bonus Depreciation*** as follows: **1)** ***Increase*** the immediate write-off percentage from the current ***50% to 100%***; **2)** ***Increase*** the first-year depreciation cap generally imposed on passenger vehicles used primarily in business ***from the current $8,000 to $16,000***; and **3)** Allow the ***100% 168(k) Bonus Depreciation*** to be taken on qualifying ***"used"*** business property (under current law, property must be ***"new"*** to qualify for the 168(k) Deduction). Property qualifying for the 168(k) Bonus Depreciation generally includes depreciable *personal* property (e.g., business equipment, computers, certain vehicles, etc), and qualifying improvements to commercial buildings. **Please note that** a more detailed discussion of business property qualifying for the *168(k) Bonus Depreciation deduction* is provided later in this letter.

Increase In The Caps On The 179 Deduction. For qualifying *179 Property* ***placed-in-service in tax years beginning after 2017 and before 2023,*** the *Act* would generally enhance the existing ***179 Deduction*** as follows: **1)** Increase the annual deduction limitation ***to $5 million*** (it is currently $510,000 for 2017); and **2)** Increase the phase-out threshold ($2,030,000 for 2017) ***to $20 million.*** Qualifying ***179 Property*** generally includes business equipment, computers, certain vehicles, and qualifying improvements to certain commercial buildings. A more detailed discussion of business property qualifying for the *179 Deduction* is provided later in this letter.

Small Business Relief For Accounting Methods. The *Act* would streamline various accounting rules for certain small businesses. For example, businesses with average gross receipts during the preceding three years of ***$25 million or less*** generally would: **1)** Be able to use the cash method of accounting even if the business has inventories; **2)** Be exempt from the UNICAP rules; and **3)** Be able to qualify for an exemption to the percentage-of-completion accounting method for qualifying long-term contracts.

New Limitations On Like-Kind Exchanges. ***Effective for exchanges completed after 2017,*** the *Act* would allow §1031 like-kind exchanges ***only with respect to real property*** (i.e., property such as business aircraft and artwork held for investment would no longer qualify). However, the *Act* contains a transition rule allowing like-kind exchanges of personal property held in a trade or business or for investment to be completed if the taxpayer has either ***disposed of the relinquished property*** or ***acquired the replacement property*** ***<u>on or before December 31, 2017.</u>***

<u>Caution!</u> We have highlighted only *selected* tax changes contained in the *Act* that would impact businesses, there are many more! If you have heard about other proposed legislative tax changes not discussed above, and you need more information, please call our office.

<u>TAX RELIEF DUE TO RECENT HURRICANES</u>

On September 29, 2017, President Trump signed the **"*Disaster Tax Relief and Airport and Airway Extension Act of 2017"*** (*"Disaster Relief Act"*) providing tax relief for victims of Hurricanes Harvey, Irma, and Maria. The IRS has also released a series *of* ***Announcements*** providing additional administrative relief for taxpayers impacted by the hurricanes. The relief generally applies to individuals and businesses located in Florida, Georgia, certain counties in Texas, certain counties in South Carolina, certain parishes in Louisiana, parts of Puerto Rico, and the Virgin Islands. In some situations, taxpayers not located in these disaster areas may qualify for relief (e.g., Where business records are located in the designated disaster areas or where taxpayers own an interest in an S corporation or partnership with primary business operations in the designated disaster areas).

Tax relief under the *Disaster Relief Act* generally includes: Larger deductions for personal casualty losses; Expanded options to take tax-favored withdrawals or loans from retirement plans; Option of using current or prior year's income for purposes of claiming the earned income and child tax credits; Increased limitation on charitable contribution deductions for individuals and businesses making qualifying charitable contributions for hurricane disaster relief; and a maximum $2,400 credit for wages paid to employees while a business in a hurricane disaster zone is out of operation.

Administrative relief granted by the IRS generally encourages leave-based donation programs for hurricane victims, and allows retirement plans to make hardship distributions. ***In addition,*** the IRS has provided automatic extensions for various IRS deadlines. ***For example,*** the IRS has extended ***<u>until January 31, 2018</u>*** the deadlines for filing the following returns: Individual, corporate, and estate and trust income tax returns; partnership returns, S corporation returns; estate, gift, and generation skipping transfer tax returns; annual information returns of tax exempt organizations; employment and excise tax returns (including payroll tax returns due October 31, 2017), and 5500s that were ***otherwise due*: 1)** On or after ***August 23, 2017*** for ***qualifying Texas taxpayers*, 2)** On or after **August 27, 2017 for qualifying Louisiana taxpayers, 3)** On or after ***September 4, 2017 for Florida taxpayers*, 4)** On or after ***September 6, 2017 for qualifying South Carolina taxpayers*,** and **5)** On or after ***September 7, 2017 for Georgia taxpayers*.** This automatic extension generally applies to ***individual filers*** with ***extensions of time to file until October 16, 2017*,** and to ***business returns*** with ***extensions until September 15, 2017.***

<u>KEEP AN EYE ON PREVIOUSLY-EXPIRED BUSINESS TAX BREAKS</u>

For over a decade, we have been faced with a long list of popular but temporary tax breaks for businesses with various expiration dates. In the past, Congress temporarily extended the majority of these tax breaks every few years. Fortunately, last year's ***Protecting Americans From Tax Hikes Act Of 2015 (PATH Act)*** removed or significantly extended the expiration dates for many of the most popular previously-expiring business tax breaks. However, there were several targeted business tax breaks which ***expired at the end of 2016*** that the PATH Act ***did not extend.*** Business tax breaks ***that expired after 2016*** include: Deductions for Certain Energy-Efficient Commercial Buildings; Credit for Certain Energy-Efficient New Homes; 7-Year Depreciation Period for Certain Motor Sports Racetrack Property; a Host of Tax Benefits for Qualified Energy-Efficient Expenditures and for Qualifying Investments in Empowerment Zones; and, 3-Year Depreciation Period for Certain Race Horses. **<u>Planning Alert!</u>** Although the PATH Act failed to extend several of the energy-related business tax breaks, it did extend the ***30% business credit*** for certain ***solar energy property*** fully ***through 2019.*** However, this credit begins phasing ***out after 2019.***

Caution! Although Congress has traditionally extended a majority of the expiring tax breaks in the past, there appears to be less likelihood that the current Congress will be extending these expired tax breaks. However, there is always a chance. Please call our Firm if you would like a status report on these expired items.

TRADITIONAL YEAR-END TAX PLANNING TECHNIQUES

A traditional year-end tax planning strategy for businesses includes reducing current year taxable income by deferring taxable income into later years and accelerating deductions into the current year. This strategy can save taxes where the income tax rate on the business's income in the following year will be the same or greater than the current-year tax rates. This strategy may be even more effective for 2017 tax years if the current tax reform proposals become law and substantially reduce the tax rates on business income beginning in 2018, as advertised. A popular way for businesses to maximize current-year deductions is to take advantage of the ***First-Year 168(k) Bonus Depreciation Deduction,*** the ***179 Deduction*****,** and/or the ***De Minimis Safe Harbor Election*****,** each of which is discussed below.

PLANNING WITH THE FIRST-YEAR 168(k) BONUS DEPRECIATION DEDUCTION

For the past several years, one of the most popular tax-favored deductions has been the first-year *168(k) Bonus Depreciation* deduction. Although the *PATH Act* extended the *168(k) Bonus Depreciation* deduction, it did not make it permanent. Instead, the *Path Act* generally extended the *168(k) Bonus Depreciation* for *qualifying* "new" business property as follows: **1)** A ***50% 168(k) Bonus Depreciation*** allowance for qualified property placed-in-service ***in 2015 through 2017*****; 2)** A ***40% 168(k) Bonus Depreciation*** allowance for qualified property placed-in-service ***in 2018*****;** and **3)** A ***30% 168(k) Bonus Depreciation*** allowance for qualified property placed-in-service ***in 2019.*** The ***168(k) Bonus Depreciation Deduction generally sunsets altogether*** for property ***placed-in-service after 2019.*** **Planning Alert!** The *Path Act* provides for a slightly longer extension of the *168(k) Bonus Depreciation* for certain long-production-period property and qualifying noncommercial aircraft.

To maximize write-offs for 2017, it is important for your business to determine which capital expenditures between now and the end of the year will qualify for the *50% 168(k) Bonus Depreciation* Deduction. The following summarizes three general categories of depreciable property that qualify:

- **New Depreciable Property With A Depreciable Life Of 20 Years Or Less.** Property qualifying for the ***168(k) Bonus Depreciation*** generally includes business property purchased ***new*** that has a depreciable life for tax purposes of ***20 years or less*** (e.g., machinery and equipment, furniture and fixtures, sidewalks, roads, landscaping, computers, computer software, farm buildings, and qualified motor fuels facilities).

- **New Business Vehicles.** *"New"* vehicles used primarily in business generally qualify for the *168(k) Bonus Depreciation*. However, there is a dollar cap imposed on business cars and trucks that have a ***loaded vehicle weight of 6,000 lbs or less.*** More specifically, vehicles ***placed-in-service in 2017*** and used 100% for business are allowed ***maximum depreciation*** (including the Section 179 deduction as discussed below) ***of $3,160*** ($3,560 for trucks and vans) ***for 2017.*** However, for 2017, these caps are ***increased by $8,000*** (i.e., $11,160 and $11,560 for trucks and vans) for qualifying new vehicles. This *$8,000 increase* begins ***phasing out after 2017,*** as follows: 2018 - $6,400; 2019 - $4,800; -0- after 2019. **Planning Alert!** This essentially means you would be able to deduct as first-year depreciation up to $1,600 more (i.e., $8,000 less $6,400) if you placed the new vehicle in service in 2017, rather than in 2018.

- **New Qualified Improvement Property.** For ***property placed-in-service after 2015,*** the *PATH Act* provides that the *168(k) Bonus Depreciation* applies to *"Qualified Improvement Property."* ***"Qualified Improvement Property"*** (QIP) is generally an improvement to the ***interior portion*** of an ***existing commercial building*** (provided the improvement is not attributable to an enlargement of the building, elevators or escalators, or the internal structural framework of the building). **Planning Alert!** Before the *PATH Act*, improvements to an existing commercial building did not qualify for the *168(k) Bonus Depreciation* unless the building was subject to a lease between unrelated parties. Moreover, the building improvement did not qualify unless the improvement was placed-in-service more than three years after the building itself was placed-in-service. ***After 2015,*** an otherwise qualifying improvement to a commercial building is allowed whether or not the building is leased, and even if the building is leased to a related party. Also, the improvement only needs to be placed-in-service after the building was *"first-placed-in-service"* (i.e., there is no longer a 3-year requirement).

First-Placed-In-Service. As noted above, to qualify for the *168(k) Bonus Depreciation*, the improvement must be placed-in-service ***after*** the building ***was first-placed-in-service.*** The IRS recently issued pro-taxpayer guidance on when a building is *first-placed-in-service*. ***For instance,*** the guidance clarifies that a building would be considered to have been *first-placed-in-service* even if the building's first usage was for a *"personal activity."* Thus, for example, it would appear that the costs of an improvement to an existing room in a personal residence as part of converting the room to a *"qualifying home office"* would qualify, assuming the improvement was made after the home was first placed-in-service.

Planning Alert! The new IRS guidance indicates that an otherwise qualifying improvement to a commercial building could qualify as QIP (i.e., qualify for the *168(k) Bonus Depreciation*), even where the improvement is placed-in-service ***one day after*** the building is first-placed-in-service. **Caution!** The IRS guidance makes it clear that this so-called *"one-day-rule"* will apply only if the taxpayer can clearly establish that the building was in fact placed-in-service at least one day before the improvement was placed-in-service. For tax purposes, property is generally considered as *"placed-in-service"* when *ready and available for use* for its intended purpose. **Caution!** Determining the exact date an asset is *placed-in-service* continues to be litigated by the IRS in certain situations. Please call our Firm if you need assistance in determining whether your newly-acquired or newly-improved business property has been *"placed-in-service."*

Tax Tip! As mentioned above, businesses have the ***full 50% 168(k) Bonus Depreciation through 2017*** for qualifying property. Neither the ***168(k) Bonus Depreciation*** (nor the *179 Deduction* discussed below) requires any proration based on the length of time that an asset is in service during the tax year. Therefore, your business would get the benefit of the ***entire 50% 168(k) Bonus Depreciation*** for 2017 purchases, even if the qualifying property ***were placed-in-service as late as December 31, 2017!*** **Caution!** If the same property is placed-in-service in early 2018 (rather than the end of 2017), under current law it would only ***qualify for a "40%"*** (not 50%) ***168(k) Bonus Depreciation.***

- **Proposed Tax Reform!** Please keep in mind, the Ways and Means Committee's proposed Tax Reform Bill would increase the 168(k) Depreciation Deduction for 2017 from **50% to 100% for property acquired and placed-in-service after September 27, 2017 and before 2023, and would generally allow the §168(k) Depreciation Deduction for used as well as new property.** In addition, the tax rates on businesses are scheduled to be reduced for tax years beginning after 2017. Therefore, if this legislation passes, businesses with higher tax rates in 2017 than in 2018 could benefit even more from placing §168(k) property in service in a tax year beginning before 2018.

PLANNING WITH THE SECTION 179 DEDUCTION

Another popular and frequently-used business tax break is the up-front Section 179 deduction (*"179 Deduction"*). For *179 Property* placed-in-service ***in tax years beginning after 2015***, the *PATH Act* made several *taxpayer-friendly* enhancements to the *179 Deduction* including: **1)** Indexing the dollar caps for inflation **(*for 2017*** the ***maximum deduction is $510,000*** and the phase-out threshold ***begins at $2,030,000*)**, and **2)** Removing the $250,000 179 deduction cap for *"Qualified Real Property" (QRP*) - however, the overall caps (i.e., of $510,000 and $2,030,000 for 2017) do apply to *QRP* along with all other §179 property.

Proposed Tax Reform! Please keep in mind, the Ways and Means Committee's proposed Tax Reform Bill **would increase the §179 Deduction** limitation for property placed-in-service **in tax years beginning after 2017** and before 2023 **to $5,000,000 and would increase the phase-out threshold to $20,000,000.** In addition, the Bill would allow the §179 deduction for certain **"Qualified Energy Efficient Heating and Air-conditioning Property"** acquired and placed-in-service **after November 2, 2017.** These proposed changes, along with the proposed reduction in the tax rates on businesses which, under the Bill, are proposed to be reduced for tax years beginning after 2017, would make year-end tax planning with §179 property acquisitions quite complicated, if this proposed legislation becomes law.

Property Qualifying For The 179 Deduction. To maximize your *179 Deductions* for 2017, it is important for your business to determine which depreciable property acquired during the year qualifies as *179 Property.* The following summarizes five general categories of *depreciable* property qualifying for the §179 deduction:

- **New And Used Depreciable, Tangible Personal Property.** Generally, "*depreciable*" property qualifies for the ***179 Deduction*** if: **1)** It is purchased ***new or used*****, 2)** It is *"tangible personal"* property, **and 3)** It is used primarily in your business (e.g., machinery and equipment, furniture and fixtures, business computers, etc.). **Caution!** Property used in ***connection with lodging*** (other than hotels, motels, etc.) ***does not qualify*** for the *179 Deduction*, but may (if new) qualify for the *168(k) Bonus Depreciation* discussed previously.

  Tax Tip. Historically, heating and air conditioning units did not qualify for the *179 Deduction*. However, after the *PATH Act*, such units now qualify for the *179 Deduction* ***provided the units are not structural components of a building.*** Recent IRS guidance provides the following examples of air conditioning or heating units that would qualify for the *179 Deduction*: *portable* air conditioners (such as window air conditioning units) and *portable* heaters (such as portable plug-in unit heaters). **Caution!** This same IRS guidance warns that the following air conditioning or heating units ***will generally not*** qualify for the *179 Deduction*: any component of a central air conditioning or heating system of a building, including motors, compressors, pipes, and ducts, whether the component is in, on, or adjacent to a building. **Planning Alert!** The cost of these items could still qualify for the *179 Deduction* if they are included in expenditures that meet the definition of *"Qualified Real Property,"* discussed in more detail below or they are not considered "structural components" of the building under case law.

- **Business Software.** The only *"intangible"* property that qualifies for the *179 Deduction* is depreciable off-the-shelf business software.

- **Business Vehicles.** New or used business vehicles generally qualify for the *179 Deduction*, provided the vehicle is used more-than-50% in your business. **Planning Alert!** As discussed previously in the *168(k) Bonus Depreciation* segment, there is a dollar cap imposed on business cars and trucks that have a ***loaded vehicle weight of 6,000 lbs or less.*** More specifically, vehicles ***placed-in-service in 2017*** and used 100% for business are allowed ***maximum depreciation of $3,160*** **(*****including the Section 179 Deduction*** and the ***168(k) Bonus Depreciation*****).** The cap for 2017 is $3,560 for trucks and vans. However, for 2017, as previously discussed these caps are ***increased by $8,000*** (i.e., $11,160, and $11,560 for trucks and vans) for new vehicles that qualify for the *168(k) Bonus Depreciation.* This *$8,000 increase* begins ***phasing out after 2017,*** as follows: 2018 - $6,400; 2019 - $4,800; -0- after 2019.

- **So-Called "Heavy Vehicles" Exempt From Dollar Caps.** Trucks and SUVs that ***weigh over 6,000*** **lbs** are generally exempt from the annual depreciation caps discussed above. These new or used "heavy vehicles" if used more-than-50% in business, will also generally qualify for the ***179 Deduction*** **of up to $25,000.** Moreover, if this *heavy vehicle* is *"new"* and used more-than-50% in business, it will likewise qualify for the *168(k) Bonus Depreciation* without the $25,000 limit. **Tax Tip!** Pickup trucks with loaded vehicle weights over 6,000 lbs are exempt from the $25,000 limit to the *179 Deduction* (imposed on SUVs) if the truck bed is at least six feet long.

  Example. Buying a *heavy vehicle* ***in 2017*** for use in your business can generate a substantial deduction. For example, let's assume that in 2017 you purchase and place-in-service a new *"over-6,000 lb"* SUV for $50,000 used entirely for business. For 2017 you could deduct: **1)** Up to $25,000 as a *179 Deduction*, **2)** 50% of the remaining balance as first-year *168(k) Bonus Depreciation*, and **3)** 20% of the remaining cost as regular depreciation for the first year. Thus, for a $50,000 new heavy SUV placed-in-service in 2017, you could generally write off $40,000 in 2017 (assuming 100% business use and the half-year depreciation convention applies).

<u>Caution!</u> If you take the *179 Deduction* and/or the *168(k) Bonus Depreciation* on your business vehicle (whether or not it weighs more than 6,000 lbs), and your business-use percentage later ***drops to 50% or below***, you will generally be required to bring into income a portion of the deductions taken in previous years.

- **<u>Qualified Real Property.</u>** "*Qualified Real Property"* is the only non-personal property that qualifies for the *179 Deduction*. *Qualified Real Property* includes property within any of the following three categories: **1) "*Qualified Leasehold Improvement Property"*** (generally improvements to the interior portion of non-residential buildings that are subject to a lease between unrelated parties, and that were placed-in-service more than 3 years after the commercial building itself was placed-in-service, if more than 50% of the building's square footage is devoted to the preparation of, and seating for, the on-premises consumption of prepared meals). **<u>Planning Alert!</u>** *Qualified Real Property* (QRP) is subject to the ***overall 179 Cap*** of ***$510,000*** (for 2017) and the ***overall phase-out threshold*** of ***$2,030,000*** (for 2017). **<u>Caution!</u>** These caps apply to ***all*** *179 Property* (including QRP) ***in the aggregate.***

  <u>Tax Tip.</u> Neither the ***179 Deduction*** nor the *168(k) Bonus Depreciation* requires any proration based on the length of time that an asset is in service during the tax year. Therefore, your business would get the benefit of the ***entire 179 Deduction*** (as well as the *168(k) Bonus Depreciation* Deduction, if applicable) for 2017 purchases, even if the qualifying property ***was placed-in-service as late as December 31, 2017!***

<u>Planning With The Section 179 Taxable Income Limitation.</u> The *179 Deduction* is limited to a taxpayer's *"trade or business"* taxable income (determined without the *179 Deduction*) for the tax year. Any excess *179 Deduction* is carried forward to later years until the taxpayer generates enough business taxable income to fully deduct it. This generally means that this *"taxable income limitation"* will not limit the taxpayer's Section *179 Deduction* for a specific tax year so long as the taxpayer has aggregate net income from all trades or businesses at least equal to the *179 Deduction* for that tax year. For this purpose, a taxpayer's *trade or business* income includes W-2 wages reported by the taxpayer or the taxpayer's spouse (if filing a joint return). ***For example,*** assume Beth is employed as an attorney with a salary of $75,000. On the side, Beth also operates a small one-person photography business (operating as a sole proprietorship that is not considered a "hobby"), and expects to earn $5,000 of gross revenue in 2017. She would like to purchase photography equipment before the end of 2017 costing $9,000 for use in her side business. Since her $75,000 salary counts for purposes of the "*taxable income limitation*," if she buys the $9,000 photography equipment and places it in service by December 31, 2017, she will be allowed a Section *179 Deduction* for the entire $9,000 for 2017.

- **<u>Planning Alert!</u>** There is no *"taxable income limitation"* with respect to the *168(k) Bonus Depreciation* deduction. Therefore, the *168(k) Bonus Depreciation* could generate a tax loss for a taxpayer. This in turn could generate a current year *"net operating loss"* (NOL) which the taxpayer could carry back and offset taxable income generated in the preceding 2 years, and carry forward any excess for up to 20 years.

<u>Make Sure Newly-Acquired Property Is "Placed-In-Service" By Year End.</u> In order to take the *168(k) Bonus Depreciation Deduction* and/or the *179 Deduction* in 2017 (assuming a calendar-year taxpayer), any newly-acquired asset must actually be **"*Placed-In-Service"*** no later than ***December 31, 2017.*** Generally, if you are purchasing *"personal property"* (equipment, computer, vehicles, etc.) – *"placed-in-service"* means the property is ***ready and available*** for use. To be safe, qualifying property should be ***set up and tested*** on or before the ***last day of 2017.*** If you are dealing with building improvements (e.g., qualified leasehold improvement property; qualified improvement property; non-structural components of a building), a ***Certificate of Occupancy*** will generally constitute placing the building improvements in service.

<u>Cost Segregation Studies Can Maximize The 179 Deduction (And Also The 168(k) Bonus Depreciation Deduction).</u> Depreciable components of a building that are properly classified as depreciable *personal* property under a ***cost segregation study*** are generally depreciated over 5 to 7 years. Assuming that you have not exceeded the various caps for the *179 Deduction*, these properly segregated non-structural components should ***qualify for the 179 Deduction*** – whether new or used. In addition, if these non-structural components are ***"new"*** and have a ***depreciable life of 20 years or less***, they should qualify for the ***50%***

168(k) Bonus Depreciation for 2017 – if the building is ***placed-in-service in 2017.*** **Planning Alert!** Obtaining a certificate of occupancy for building improvements ***by December 31, 2017*** will generally constitute placing the building improvements in service by that date.

DON'T OVERLOOK THE *"DE MINIMIS SAFE HARBOR"*

As your business considers its year-end purchases of depreciable property, don't overlook the opportunity to ***make an election*** that allows an ***immediate deduction*** of up to a certain dollar amount for purchases of ***individual items*** of tangible business property (including materials and supplies). For taxpayers that have ***"Applicable Financial Statements"*** (i.e., financial statement filed with the SEC, certified audited financial statement, or financial statement required to be provided to the Federal or a State government – other than a tax return) the dollar cap is ***$5,000 per each individual item.*** For taxpayers ***without*** *"Applicable Financial Statements"* **(*most small and mid-size businesses*),** the dollar cap is ***$2,500 for each item.***

- **De Minimis Safe Harbor Election.** A taxpayer must make an *"election"* to take advantage of this ***"De Minimis Safe Harbor."*** The election is made annually (by attaching a statement to a timely filed—including extensions—original Federal income tax return). To qualify for the safe harbor, the taxpayer generally must have an ***accounting procedure*** (as of the beginning of the year) to expense the cost of assets costing less than a specified amount (e.g., $2,500 or less) for *"nontax"* purposes as well as for tax purposes. If the taxpayer has an *"applicable financial statement,"* the accounting procedure ***must be in writing.*** For taxpayers that do not have an *"applicable financial statement*" (again most small and mid-size businesses), the *"beginning-of-the-year"* accounting procedure referred to above does not have to be in writing. However, having a written procedure may better document your *"expensing procedure"* in case of an IRS audit.

- **Planning Alert!** The determination of whether a specific *"item"* costs $2,500 or less (or $5,000 or less) is generally based on the cost stated in the invoice. If there are several items listed in the same invoice, the *"$2,500/$5,000"* cap is applied to the cost of *each* item listed in the invoice (assuming that the specific cost of each item is listed in that invoice). In addition, the *$2,500/$5,000* cap for each item must generally include any amount ***charged in the same invoice*** by the vendor or supplier for delivering or installing that specific item. However, if the delivery or installation cost is charged in an invoice separate from the invoice for the item itself, the delivery or installation costs ***are not included*** in *$2,500/$5,000* cap for each item. **Tax Tip.** Assume that a taxpayer without an *Applicable Financial Statement* purchases a single computer for $2,400, with additional delivery, installation, and set-up fees of $400. If the $2,400 cost of the computer and the $400 additional fee are reflected on the same invoice, the computer would be deemed to cost $2,800 (i.e., $2,400 plus $400), and would be above the $2,500 safe-harbor cap. However, if the taxpayer arranged to have the vendor send one invoice charging $2,400 for just the computer, and a separate invoice only containing the additional fees of $400, then ***both*** the $2,400 charge for the computer and the separately-invoiced charge $400 ***would qualify*** for the $2,500 safe harbor. **Caution!** There are anti-abuse rules designed to keep taxpayers from being overly aggressive with this taxpayer-friendly rule.

- **Tax Tip!** Deductions under this safe harbor are not impacted by either the *168(k) Bonus Depreciation Deduction* or the *179 Deduction*, and purchases deducted under this *De Minimis Safe Harbor* are allowed ***in addition to*** the *179 Deduction*. ***For example,*** assume for 2017, a business (with no *applicable financial statement*) deducts as an immediate expense all individual purchases of $2,500 or less under this safe harbor, and those aggregate purchases for the year totaled $150,000. Since the $150,000 does not count against the Section 179 limits, the taxpayer would still have the ***full*** $510,000 cap for 2017 for items of *179 Property* that cost over $2,500 each.

SELECTED TRADITIONAL YEAR-END PLANNING CONSIDERATIONS FOR BUSINESSES

Year-End Planning For Personal Service Corporations. If you own a "C" corporation that is a personal service corporation (PSC), all income retained in that corporation is taxed at a flat rate of 35%. Your C corporation is a PSC if its business is primarily in the areas of health, law, accounting, engineering, actuarial sciences, performing arts, or consulting. Furthermore, in order to be classified as a PSC, substantially all of your corporation's stock must be held by employees who are performing those services. **Tax Tip.** Generally, it is preferable from a tax standpoint to leave as little taxable income in a PSC as possible. This may be accomplished by paying reasonable salaries and compensation to the stockholder/employees **by year-end.**

Salaries For S Corporation Shareholder/Employees. For 2017, an employer generally must pay FICA taxes of 7.65% on an employee's wages up to $127,200 and FICA taxes of 1.45% on wages in excess of $127,200. In addition, an employer must withhold FICA taxes from an employee's wages of 7.65% on wages up to $127,200 and 1.45% of wages in excess of $127,200. Generally, the employer must also withhold an additional Medicare tax of .9% for wages paid to an employee in excess of $200,000.

If you are a shareholder/employee of an S corporation, this FICA tax is generally applied only to your W-2 income from your S corporation. Other income that passes through to you or is distributed with respect to your stock is generally not subject to FICA taxes or to self-employment taxes.

- **Compensation Must Be "Reasonable."** If the IRS determines that you have taken unreasonably "low" compensation from your S corporation, the Service will generally argue that other amounts you have received from your S corporation (e.g., distributions) are disguised "compensation" and should be subject to FICA taxes. Determining "reasonable compensation" for S corporation shareholder/employees is a hot audit issue, and the IRS has a winning record in the Courts. Over the years, the IRS has been particularly successful in reclassifying distributions as wages where S corporation owners pay themselves ***no wages*** even though they provided significant services to the corporation. However, more recently, there have been several cases where the S corporation owners paid themselves ***more than de minimis wages,*** but the Court still held that an additional portion of their cash "distributions" should be reclassified as "wages" (subject to payroll taxes). **Caution!** Determining "reasonable" compensation for an S corporation shareholder is a case-by-case determination, and there are no rules of thumb for determining whether the compensation is "reasonable." However, recent Court decisions make it clear that the compensation of S corporation shareholders should be supported by independent data (e.g., comparable industry compensation studies), and should be properly documented and approved by the corporation. **Caution!** Keeping wages low and minimizing your FICA tax could also reduce your Social Security benefits when you retire. Furthermore, if your S corporation has a qualified retirement plan, reducing your wages may reduce the amount of contributions that can be made to the plan on your behalf since contributions to the plan are based upon your "wages."

- **Planning Alert!** In a recent case, a certified financial planner (CFP) set up a wholly-owned S corporation with the intent of reporting his investment advisory fees and commissions on the S corporation's tax return. He also entered into an employment agreement with his S corporation and was paid wages by the S corporation. However, the commission contracts between the CFP and the insurance company and the brokerage firm that paid him commissions were between the CFP and the insurance company and brokerage firm. The Tax Court ultimately held that the brokerage fees and commissions should have been reported by the CFP on his personal return and, therefore, all of the fees (rather than just the wages he received from his S corporation) were subject to S/E taxes. The Court based its decision in large part on the fact that the CFP had poor documentation establishing the legal relationships between the CFP, his S corporation, and the insurance company and brokerage firm. **Caution!** It is extremely important to follow the appropriate formalities (e.g., timely corporate minutes, written employment agreement with owner/employee, written contracts between the S corporation and those to whom services are rendered, etc.) for the corporation to be fully recognized for tax purposes.

Uncertainty Continues Regarding The Self-Employment Tax Treatment For Owners Of Limited Liability Companies (LLCs). ***"General"*** partners of businesses operating as partnerships are generally subject to Social Security and Medicare taxes (Self-Employment Taxes) on their business income passing through from their partnership and reported on Schedule K-1. By contrast, ***"limited"*** partners are generally exempt from Self-Employment Taxes (S/E tax) on the partnership's Schedule K-1 pass-through business income (except for *"guaranteed payments"* they receive). However, it is not entirely clear whether and to what extent pass-through business income to the owner of a Limited Liability Company (LLC) is subject to the S/E tax.

Last year, in an IRS Chief Counsel Advisory (CCA), the IRS ruled that a Member/Owner of an LLC that operated a franchise restaurant business should be treated as a *"general"* (not "limited") partner and, therefore, should be subject to S/E tax on all pass-through business income from the LLC reported on his

Schedule K-1 (whether or not distributed). The Member/Owner was active in the LLC's business operations – serving as Operating Manager, President, and Chief Executive Officer. The CCA generally concluded that an owner of an LLC could possibly qualify for the "limited partner" exception to S/E taxes *only if* the LLC owner is a ***"mere investor"*** who does not ***"actively participate"*** in the business operations of the LLC. Since the Member/Owner in this situation was not a *"mere investor"* and *"actively participated"* in the LLC's restaurant operations, the CCA concluded that S/E tax should be imposed on his share of the business income from his LLC. The CCA ***did not provide a specific definition*** of the terms *"mere investor"* or *"actively participate."* Presumably, the IRS intends to apply these critical terms on a case-by-case, facts-and-circumstances basis. **Tax Tip.** In this CCA, the Member/Owner's wife also owned an interest in the LLC, however she had no active involvement in the operations of the LLC. The CCA concluded that the LLC's business income that passed through to the Wife on her Schedule K-1 was not subject to S/E taxes because she was a *"mere investor"* and did not *"actively participate"* in the LLC's operations. There has also been several recent Court cases dealing with this issue, including:

- ***In One Recent Tax Court Case,*** the Court ultimately held that attorney-owners of a law firm operating as an LLC were subject to S/E tax on all of the Firm's pass-through business income, even though the Law Firm paid each owner a *"guaranteed payment"* in an amount that was allegedly*"reasonable compensation"* for the value of the partners' services to the firm (the partners correctly reported the guaranteed payments as S/E income). The Court pointed out that under Mississippi's Partnership Act, a limited partner could not have "control" over the partnership's business. In this case, all of the LLC members (i.e., attorneys) were managing members and had equal authority over the partnership and its employees. The Court also pointed out that under Mississippi's Partnership Act, a limited partnership had to have at least one general partner!

- ***Another Recent Tax Court Case*** dealt with a plastic surgeon who reported the income from his practice as a sole proprietor on a Schedule C and properly paid S/E tax on that income. The plastic surgeon also owned 12.5% of an LLC that operated a surgery center where the remainder of the surgery center was owned by an unrelated group of surgeons. The surgery center was operated by an outside professional management firm. Although the plastic surgeon performed some of his surgeries at the surgery center, his patients would pay the surgery center directly for its use. In this case, the Tax Court held that the pass-through business income from the surgery center to the plastic surgeon (as an LLC Member) was not subject to S/E tax. The Court concluded that the plastic surgeon's ownership interest in the surgery center closely resembled that of an *"investor"* (a limited partner) rather than that of an *"active"* participant in the operations of the surgery center (a general partner).

S Corporation Shareholders Should Check Stock And Debt Basis Before Year-End. If you own S corporation stock and you think your S corporation will have a tax loss this year, you should contact us as soon as possible. These losses will not be deductible on your personal return unless and until you have adequate "basis" in your S corporation. Any pass-through loss that exceeds your "basis" in the S corporation will carry over to succeeding years. You have basis to the extent of the amounts paid for your stock (adjusted for net pass-through income, losses, and distributions), ***plus*** any amounts you have personally loaned to your S corporation. **Planning Alert!** If an S corporation anticipates financing losses through borrowing from an outside lender, the best way to ensure the shareholder gets ***debt basis*** is to: **1)** Have the shareholder personally borrow the funds from the outside lender, and **2)** Then have the shareholder formally (with proper and timely documentation) loan the borrowed funds to the S corporation. It also may be possible to *restructure* (with timely and proper documentation) an existing outside loan directly to an S corporation in a way that will give the shareholder debt basis, however, the loan must be restructured before the S corporation's year ends. **Caution!** A shareholder cannot get debt basis by merely guaranteeing a third-party loan to the S corporation. ***Please do not attempt to restructure your loans without contacting us first.***

Making Payments On S Corporation Shareholder Loans May Trigger Income. Let's assume you have previously loaned funds to your S corporation which, in turn, created basis that you have used to deduct pass-through losses from prior years. If all or a portion of the loan is paid back after the loan's basis has been reduced by pass-through losses, you will recognize a gain on the repayment. The amount, character, and timing of the gain is dependent on several factors, including: **1)** When during the tax year the payment is made, **2)** Whether the loan is an "open account" advance, or evidenced by a written promissory note, and **3)** The amount of the unpaid balance on an "open account" advance as of the end of the tax year. For example, if the loan is an "open account" (i.e., not evidenced by a written promissory note), any gain triggered by a payment on the loan will generally be taxed at ordinary income tax rates. However, if the loan is evidenced by a written promissory note and has been outstanding for over one year, any gain triggered on the payback may qualify for favorable long-term capital gains treatment. **Tax Tip.** It may save you taxes in the long run if you postpone principal payments on the depleted-basis loan until the loan's basis has been restored by subsequent S corporation profits. ***Please consult with us before your S corporation repays a shareholder loan.*** We will help you structure the loans and any loan repayments to your maximum tax advantage.

Congress Authorizes A New Option For Certain Employers That Are Considering A Health Reimbursement Arrangement. Subject to certain safe harbor arrangements, under the current Affordable Care Act (ACA) requirements, any employer (regardless of size) that sponsors a stand-alone ***"Health Reimbursement Arrangement"*** (*HRA*) or an ***"Employer Payment Plan"*** **(*EPP*),** could face a $100-a-day penalty for each covered employee. The penalty applies only if the employer covers ***at least 2 employees*** under the HRA or EPP. The IRS defines an ***"HRA"*** as an arrangement (funded solely by an employer) that reimburses an employee for qualified medical expenses incurred by the employee ***up to a maximum dollar amount*** for a coverage period. The IRS defines an ***"Employer Payment Plan"*** as an arrangement where the employer reimburses an employee's substantiated premiums for the employee's individual medical insurance coverage (i.e., non-employer sponsored medical insurance coverage), or the employer pays the premiums directly to the insurance company. **Note!** Generally, the payment or reimbursement of individual medical insurance premiums for more-than-2% S corporation shareholder/employees is exempt from the $100-a-day penalty.

- **Good News!** Last December Congress passed legislation that now allows an *"Eligible Employer"* to sponsor an HRA or EPP without exposure to the $100-a-day penalty, provided certain requirements are met. These arrangements are called **"*Qualified Small Employer Health Reimbursement Arrangements"*** (QSEHRAs). Generally, an *"Eligible Employer"* that adopts a *QSEHRA* may reimburse up to a maximum of $4,950 ($10,000 if the arrangement also covers family members) of a qualifying employee's individual medical insurance policy premiums and/or other qualified medical expenses without incurring the $100-a-day penalty. An *"Eligible Employer"* is an employer that does not otherwise offer a group health plan and that has fewer than 50 full-time and full-time-equivalent employees during the preceding calendar year. **Planning Alert!** A *QSEHRA* must satisfy various technical requirements such as certain anti-discrimination and notification requirements. Please contact our firm if you would like additional information on these plans.

- **Planning Alert!** On ***October 12, 2017,*** President Trump issued an *Executive Order* entitled ***"Presidential Executive Order Promoting Healthcare Choice and Competition Across the United States."*** Included in that Order is a directive for the Secretaries of the Treasury, Labor, and Health and Human Services to "*consider proposing regulations or revising guidance, to the extent permitted by law and supported by sound policy, **to increase the usability of HRAs,** to **expand employers' ability to offer HRAs** to their employees, and to allow HRAs to be used in conjunction with nongroup coverage*." [Emphasis added]. The *Order* stipulates that guidance should be issued "*Within 120 days of the date of this order.*" **Caution!** As we complete this letter, no such guidance has been released. However, when and if released, it is possible that this anticipated guidance could allow an employer to offer its employees HRAs and/or EPPs under rules that are more flexible than the current *QSEHRA* requirements discussed above.

Strategies For Business Owners To Avoid The 3.8% Net Investment Income Tax. A 3.8% tax is imposed on the ***net investment income*** (*3.8% NIIT*) of ***higher-income*** *individuals*. With limited exceptions, ***"net investment income"*** generally includes the following types of income (less applicable expenses): interest, dividends, annuities, royalties, rents, "passive" income (as defined under the traditional "passive activity" loss rules), long-term and short-term capital gains, and income from the business of trading in financial securities and commodities. **Planning Alert!** Income ***is not*** *"net investment income"* (and is therefore exempt from this new 3.8% NIIT), ***if the income is "self-employment income"*** subject to the 2.9% Medicare tax. The 3.8% NIIT only applies to individuals with modified adjusted gross income (MAGI) exceeding the following ***"thresholds": $250,000*** if ***married filing jointly; $200,000*** if ***single;*** and ***$125,000*** if ***married filing separately.***

- **<u>Passive Owners Should Consider Taking Steps To Avoid The 3.8% Net Investment Income Tax (3.8% NIIT).</u>** For purposes of this 3.8% NIIT, *net investment income* includes *operating* business income that is taxed to a ***"passive"*** owner (unless the operating income constitutes *self-employment* income to the owner that is subject to the 2.9% Medicare tax). For this purpose, an owner is considered *"passive"* in a business activity if the owner is "passive" under the *passive loss limitation* rules that have been around for years. For example, you are deemed to *materially participate* (i.e., you're not "passive") if you spend ***more than 500 hours*** during the year working in the business. **<u>Observation.</u>** Traditionally, business owners have focused on the passive activity rules largely in the context of ***avoiding*** the rigid passive ***"loss"*** restrictions. Now that passive ***"income"*** can be subject to the ***3.8% NIIT,*** business owners are seeking ways to ***avoid*** passive ***"income"*** classification.

- **<u>"Passive" S Corporation Shareholders Should Take Steps To "Materially Participate."</u>** If you are an ***S corporation shareholder,*** and you ***materially participate*** in the business, your pass-through business income will generally be ***exempt*** from the 3.8% NIIT. **Note!** The pass-through income is also generally exempt from Social Security and Medicare taxes on earned income. However, if you are currently a ***"passive"*** S corporation shareholder and your MAGI exceeds the thresholds for the 3.8% NIIT (e.g., exceeds $250,000 if married filing jointly; $200,000 if single), you could possibly avoid the tax by taking steps ***before the end of 2017*** to establish that you *"materially participate"* in the business. For example, one way to *materially participate* in the business would be to devote *over 500 hours* during the year working in the business. **<u>Tax Tip.</u>** There may be other ways you can *show that you "materially participate"* in the business without working more than 500 hours. ***Please call our firm*** if you need additional details. **<u>Planning Alert!</u>** If you have other *"passive"* activities generating losses, you may prefer to remain *passive as to an activity producing income* so that the activity's income may be used to absorb the *passive* losses. **<u>Caution!</u>** These rules are complicated and require a thorough review of your particular situation to develop the most tax-wise strategy.

- **<u>Planning Alert!</u>** We have recently seen a significant uptick in the number of cases the IRS is taking to Court contesting whether an owner has *materially participated* in the activities of his or her business operation. In these cases, IRS commonly argues that the owner's activities were passive because the owner could not properly document that he or she met one of the *"material participation"* tests. These cases typically involve an owner who is not working for the business full-time (e.g., retired owners, a side business, remote owners). Although the Courts generally did not strictly require these individuals to produce daily logs of time spent on the activity, the Courts rarely accepted *"after-the-fact ballpark estimates"* of the time spent. To minimize exposure to IRS attacks, where "*material participation"* could be an issue, owners should contemporaneously document their hours worked in their business activities (e.g., by recording their hours in a daily or weekly calendar).

<u>Deductions For Business Expenses Paid By Partners And Shareholders May Be Limited.</u> Historically, the IRS has ruled that a partner may deduct business expenses ***paid on behalf*** of the partnership ***only if*** there is an agreement (preferably in writing) between the partner and the partnership providing that those expenses are to be paid by the partner, and that the expenses will not be reimbursed by the partnership. **<u>Tax Tip.</u>** If you are a partner paying unreimbursed expenses on behalf of your partnership, to be safe, you should have a written agreement with the partnership providing that those expenses are to be paid by you, and that the expenses will not be reimbursed by the partnership. **<u>Planning Alert!</u>** The Courts continue to hold that a corporate shareholder may not deduct expenses the shareholder pays on behalf of the corporation ***unless*** the shareholder is employed by the corporation, the shareholder is required to incur the expenses as a part of his or her duties as an employee, and there is an agreement or understanding that the corporation will not reimburse the expenses. Even if the expenses are deductible by the shareholder-employee, they are classified as *miscellaneous itemized deductions* which are subject to the 2% reduction rule, and are not deductible at all for *alternative minimum tax* purposes.

- ***Please note*** that these rules ***apply to both S corporation and C corporation*** shareholders. **<u>Tax Tip.</u>** If business expenses paid by a shareholder for an S corporation or C corporation are reimbursed to the shareholder under a qualified *"accountable plan*," the corporation can take a full deduction and the shareholder will exclude the reimbursement from taxable income.

Establishing A New Retirement Plan For 2017. Calendar-year taxpayers wishing to establish a qualified retirement plan for 2017 (e.g. profit-sharing, 401(k), or defined benefit plan) *generally* must adopt the plan ***no later than December 31, 2017.*** However, a SEP may be established by the due date of the tax return (including extensions), but a ***SIMPLE plan*** must have been established ***no later than October 1, 2017.***

Year-End Accruals To Employees. Generally, if an accrual-basis business accrues year-end compensation to its rank-in-file employees (non-shareholder employees), the accrual must be paid no later than the 15th day of the third month after year-end to be deductible for the year of the accrual. Otherwise, the accrual is not deductible until paid. **Planning Alert!** These rules also apply to accrued vacation pay, and to accruals for services provided by independent contractors (e.g., accountants, attorneys, etc.).

Accruals To "Related Parties." Year-end accruals to certain cash-basis recipients must satisfy the following rules in order for an accrual-basis business to deduct the accruals. **These rules apply to fiscal year as well as calendar year businesses:**

- **Regular "C" Corporations.** If a C corporation accrues an expense (e.g., compensation, interest, etc.) to a cash basis stockholder owning ***more than 50%*** (directly or indirectly) of the company's stock, the accrual is not deductible by the corporation until the **"day"** it is includable in the stockholder's income. **Tax Tip.** If the corporation's tax rate for 2017 is significantly greater than the more-than-50% stockholder's individual rate for 2017, consider paying the accrued amount to the shareholder by the ***end of 2017.***

- **S Corporations And Personal Service Corporations.** If your S corporation or personal service C corporation accrues an expense to any shareholder (regardless of the amount of stock owned), the accrual is not deductible until the ***day*** it is includable in the shareholder's income.

- **Partnerships, LLCs, LLPs.** If your business is taxed as a partnership, its accrual of an expense to ***any owner*** will not be deductible until the ***day*** it is includable in the owner's income.

- **Other Related Entities.** Generally, an expense accrued by one related partnership or corporation to another ***cash-basis*** related partnership or corporation is not deductible until the ***day*** it is includable in the cash-basis entity's income.

- **Planning Alert!** In a recent Tax Court case that caught many by surprise, the Court held that an accrual-method S corporation may not deduct the accrual of wages to *"any"* employee who is also participating in the S corporation's ESOP, until the tax year the wages are included in the employee's taxable income. The Court based its decision on its interpretation of the statutory stock ownership attribution rules. **Caution!** The holding in this case creates a potential trap for unsuspecting, accrual-method S corporations that sponsor ESOPs. For an S corporation to take a current year deduction for year-end wages accrued to employees who are also participants in an ESOP, this decision would require the wages to be ***"paid"*** by year-end and included in the employees' W-2s for that year.

Planning For C Corporation Estimated Taxes. If your C corporation had less than $1 million of taxable income for ***each*** of the past three tax years, it qualifies for the ***"small corporation safe harbor"*** for estimated taxes, which allows it to base its current year quarterly estimated tax payments on 100% of its ***"prior" year*** tax liability. If your corporation does not qualify for this safe harbor (i.e., it had $1 million or more of taxable income in any of the prior three tax years), it must generally base its quarterly estimated tax payment (after the first installment) on 100% of its "current" year tax liability, or 100% of its annualized tax liability. **Planning Alert!** Even if your corporation otherwise qualifies for the *small corporation safe harbor*, but it had no income tax liability in the prior tax year (e.g., it incurred a tax loss for the prior year or was not in existence last year), it must pay 100% of the "current" year tax or 100% of the annualized tax to avoid an estimated tax underpayment penalty. **Tax Tip.** If your corporation currently qualifies for the *"small corporation safe harbor"* and anticipates showing a small tax loss in 2017, you may want to accelerate income (or defer expenses) in order to generate a ***small income tax liability in 2017.*** This will preserve the corporation's ability to use the "100% of last year's tax" safe harbor for 2018 estimates. **Caution!** This technique may not be advisable if your corporation anticipates a 2017 net operating loss that can be carried back to previous years that would generate a sizeable refund. **Planning Alert!** If your corporation expects taxable income of more than $1 million for the first time in 2017, consider ***deferring income into 2018*** *or* ***accelerating deductions into 2017*** to ensure the corporation's 2017 taxable income does not exceed $1 million, so that it retains the *small business safe harbor* for 2018.

FINAL COMMENTS

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes. In addition, please call us before implementing any planning ideas discussed in this letter, or if you need additional information. **Note!** The information contained in this material should not be relied upon without an independent, professional analysis of how any of the items discussed may apply to a specific situation.

Disclaimer: Any tax advice contained in the body of this material was not intended or written to be used, and cannot be used, by the recipient for the purpose of promoting, marketing, or recommending to another party any transaction or matter addressed herein. The preceding information is intended as a general discussion of the subject addressed and is not intended as a formal tax opinion. The recipient should not rely on any information contained herein without performing his or her own research verifying the conclusions reached. The conclusions reached should not be relied upon without an independent, professional analysis of the facts and law applicable to the situation.