

2016

DMJ & Co., PLLC presents Year-End Tax Planning Strategies for Business

The technical information in this newsletter is necessarily brief. No final conclusion on these topics should be drawn without further review and consultation. Please be advised that, based on current IRS rules and standards, the information contained herein is not intended to be used, nor can it be used, for the avoidance of any tax penalty assessed.

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December 15, 2016

DEAR CLIENTS AND FRIENDS:

The purpose of this letter is to bring business year-end tax information to your attention as the calendar year 2016 draws to a close. Please carefully consider these items, how they may affect your business, and do not hesitate to contact us for further clarification on any of these matters.

First, please note for 2016 business tax returns, our default delivery method will be electronic. Many of our clients already prefer an electronic copy because it is easier to store, secure, and share a copy with banks or other interested parties. Just let us know what email address is good to use for confidential matters, and we will email you a secure link that will allow you to download a PDF copy of your returns. If you prefer to receive a USB with a copy, let us know and we will do that instead. We can also set you up on our portal where a copy will be available. You can, of course, continue to opt for a paper copy.

CHANGE IN DUE DATES FOR 2016 RETURNS

The Highway Funding Act of 2015 (the Act) sets new due dates for partnership and C corporation returns, as well as FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), and several other IRS information returns.

For partnership returns, the new due date is March 15 (for calendar-year partnerships) and the 15th day of the third month following the close of the fiscal year (for fiscal-year partnerships). The Act directs the IRS to allow a maximum extension of six months for Form 1065, U.S. Return of Partnership Income.

For C corporations, the new due date is the 15th day of the fourth month following the close of the corporation's year. Corporations will be allowed a six-month extension, except calendar-year corporations would get a five-month extension, and corporations with a June 30 year end would get a seven-month extension. In 2026, these rules are scheduled to change again.

The new due dates will apply to returns for tax years beginning after December 31, 2015. However, for C corporations with fiscal years ending on June 30, the new due dates will not apply until tax years beginning after December 31, 2025.

The due date for FinCEN Form 114 is changed from June 30 to April 15, and for the first time, taxpayers will be allowed a six-month extension. As of this writing, we do not know the form and rules of this extension.

W-2/W-3 and 1096/1099-MISC

Part of the 2015 PATH Act (described on next page) enacted last December moved the deadline for filing forms W-2/W-3 and 1096/1099-MISC. We have always been required to provide these forms to the recipient by January 31 and to the government by February 28. But beginning for 2016 forms filed in 2017, the government Forms W-2/W-3 to SSA and 1096/1099-MISC to IRS are also due by January 31.

To be clear, this government deadline moving from February 28 to January 31 does not apply to all 1099-MISCs, only the Forms 1099-MISC with non-employee compensation in Box 7.

Further, the Trade Preferences Extension Act of 2015 greatly increased the penalties for not meeting these deadlines. The penalty for failing to file by the deadline was increased to \$250 per form, doubling to \$500 per form where the failure is intentional. Where the form is merely late, the penalty is \$50 per form if 30 days or less late. If the form is filed by August 1 of the year due, the penalty is \$100 per form.



PLANNING AHEAD TO 2018

On November 2, 2015, President Obama signed into law The Bipartisan Budget Act of 2015 making radical changes to the partnership audit rules that, as their primary goal, make it easier for the Internal Revenue Service (the "IRS") to audit partnerships and collect tax from those audits. The new partnership audit rules are effective beginning in 2018, so there is some time between now and the effective date to establish a cogent operating set of procedures and guidelines given the legislative changes.

The IRS has issued temporary regulations explaining how a partnership may elect to have the new partnership audit rules apply to any partnership tax year beginning after November 2, 2015, and before January 1, 2018. We are not prepared to suggest that this is a good idea at this time, but partners have the opportunity to avail themselves of the new rules when a new audit begins.

- **Action item.** Partnerships, general partners, managers, and their partners should re-examine existing partnership, LLP, LLC, etc. agreements to determine what revisions will need to be made in light of the new partnership audit rules before 2018.

The Protecting Americans Against Tax Hikes (“PATH”) Act of 2015

Last year, Congress had addressed many expired tax provisions by renewing and making certain extenders permanent. Some of the more widely used extenders were:

1. Code Section 179 expensing – The 2014 level of \$500,000 of expensing, which begins to phase out at \$2,000,000 of capital investment, was made permanent. The amounts are indexed for inflation, and for 2016, expensing maximum has not changed, but the investment limit has been indexed to begin at \$2,010,000. For 2017, the expensing maximum will be indexed to \$510,000, and the investment limit will begin at \$2,030,000.
 2. Bonus depreciation under Code Section 168(k) was extended under a phase-down schedule through 2019. The deduction level is 50% for 2016 and 2017.
 - Bonus qualifying property was expanded to include qualified improvement property which is generally defined as any improvements to an interior portion of a building that is non-residential real property.
 3. Qualified leasehold improvements – 15-year straight-line cost recovery was extended permanently.
 4. Air conditioning and heating units may qualify for the Code Section 179 expensing deduction if the units constitute Section 1245 tangible property (i.e., not structural components of a building) if placed in service in tax years beginning in 2016.
 5. The research credit was made permanent after 2015. The R&E credit for an eligible small business may offset both regular and AMT liabilities as well as FICA tax liability for tax years beginning after 2015.
- **Action item.** We can help you project the effect of these rules for your 2016 planning.

GENERAL BUSINESS PLANNING CONCEPTS

Cash basis businesses that want to defer 2016 income into 2017 should consider sending end of year invoices very late so that customers do not remit their payment until 2017. Also, try to avoid having unpaid bills on hand at the end of the year so as to garner a 2016 deduction. Remember that expenses paid with a credit card are considered paid when charged, even if the credit card bill is outstanding at year end.

Accrual basis businesses that want to defer 2016 income into 2017 should defer providing goods and services until next year. This may or may not be a wise business decision – you will need to decide that for yourself.

For additional deductions, consider establishing a retirement plan this year. A 2017 retirement plan contribution for 2016 is deductible in 2016, whether your business reports on the accrual or cash basis, as long as the payment is made by your business tax return deadline, including extensions.

If losses are expected, S corporation business owners should make sure that they have sufficient basis to deduct the losses on their tax return. Please see us for how to increase your basis before year end.

IRS INCREASES CAPITAL ASSET SAFE HARBOR DEDUCTION AMOUNT FOR BUSINESSES

In 2015, the IRS announced that it was increasing the de minimis safe harbor deduction amount for taxpayers without an applicable financial statement (AFS, which generally are audited financial statements) under Reg 1.263(a)-1(f)(1)(ii) from \$500 to \$2,500. (The IRS did not change the \$5,000 safe harbor amount for taxpayers that have an AFS). This basically means that a taxpayer can adopt a capitalization policy for fixed assets at \$2,500. Notice 2015-82 provides that the higher \$2,500 safe harbor amount is effective for costs incurred during taxable years beginning after 2015.

- **Action item.** If you have not increased your capitalization policy to conform to this notice, you might want to consider updating by the end of the year. DMJ has a standard capitalization policy template for this if you would like to update it for 2016.

THE AFFORDABLE CARE ACT (a/k/a “OBAMACARE”)

Beginning in January 2015, employers with 50 full-time-equivalent employees (Applicable Large Employers or ALEs) were required to begin providing health insurance to their employees. The penalty consequences for failure to offer such coverage is severe, therefore, there was transitional relief in 2015 that is no longer available. Some examples of the changes are:

1. ALEs are required to offer coverage to full-time employees' dependents in 2016.
2. ALEs are required to offer MEC (minimum essential coverage) to at least 95% of full-time employees and their dependents.
3. Employers must measure their ALE status for 2016 using all twelve months of 2015.
4. If an ALE is subject to the employer-shared responsibility payment (penalty), the payment will be calculated by reducing the ALE's full-time employees by 30.

Employers received some welcome relief when the IRS issued Notice 2016-70 extending employee notification deadline for Affordable Care Act (ACA) information reporting. The forms that are required to be sent to employees/responsible individuals are due March 2, 2017. This applies only to 2016 as the IRS has indicated it doesn't anticipate extending this transitional relief.

Are you sure that your business is prepared? We urge you to consult with your health insurance provider to see whether you are required to provide health insurance, to make sure that your plan is in compliance, and that you are offering insurance to all eligible employees and dependents. The penalties are significant for failing to completely comply with these requirements.

Action item. Check with your HR or employee benefits consultant to make sure that all ACA coverage requirements and filings are being addressed.

YEAR-END FORM W-2 REMINDERS

Remember that several year-end adjustments are needed for your W-2 filings. These include the following – contact us if you need assistance in calculating these amounts:

- If you provide a company vehicle to any employee (including company owners), the value of the personal use of the vehicle must be included in the W-2. This is income for federal and state withholding, FICA, Medicare, and FUTA purposes.
- For this and similar non-cash compensation, you obviously cannot withhold tax when there is no cash payment. Therefore, you need to calculate this additional W-2 income before the last payroll of the year so that you can withhold additional tax from the last payroll, if needed.
 - **Action item.** Include the income from personal auto use in the W-2 of any employee with personal auto use. Get with us and we will be happy to assist you with this calculation.
- If you provide group-term life insurance in excess of \$50,000 to employees, the value of the life insurance in excess of the \$50,000 must be included in the W-2. We can help with this calculation. Note that this should not be taken to read that the employer’s payment of the life insurance premium for anyone does not represent taxable compensation. A life insurance plan must meet specific requirements to be considered group-term life.
 - **Action item.** Include the income from excess group-term life insurance in the W-2 of all employees. We can assist with this calculation.
- For “S” corporations, the amount the company paid for accident and health insurance (including dental, cancer, long-term care, and other policies) must be included in the W-2 of certain shareholders (those owning more-than-2% directly or indirectly of the company, including spouses, children, parents, and grandchildren). The amount paid is taxable for federal and state withholding purposes, but is not taxable for FICA, FUTA, or Medicare purposes.
 - **Note – The IRS has stated its intention to disallow the deduction for health insurance for more-than-2% “S” corporation shareholders if the company fails to include this health insurance in the W-2 of the shareholder.**
 - **Action item.** Include the amount paid by the company for health, dental, and long-term care insurance for more-than-2% “S” corporation direct and indirect shareholders in their W-2 for 2016.
- Note that if the business pays for country club dues or similar social clubs for owners or officers and that membership is actually in the name of the individual instead of the business, then this payment is additional compensation and should be included in the W-2. It does not matter that the primary purpose of such use is for business marketing.

YEAR-END FORM 1099 INFORMATION REPORTING REQUIREMENTS

Part of the 2015 PATH Act enacted last December moved the deadline for filing certain Forms 1096/1099-MISC. Taxpayers have always been required to provide these forms to the recipient by January 31 and to the government by February 28. Beginning for 2016 forms filed in 2017, some government forms to SSA are also due by January 31. Please refer to the section above under W-2/W-3 and 1096/1099-MISC for late and non-filing penalties as these have increased.

The reason for this change is to get compensation information into the government computers quicker, which will help them in their fight against identity theft and bogus filings.

To be clear, the government deadline moving from February 28 to January 31 does not apply to all 1099s and 1099-MISCs. This only applies to Forms 1099-MISC with non-employee compensation in Box 7. Remember that the point of this rule change is to get compensation information to the government sooner.

Every person engaged in a trade or business must file an information return for payments made to another person, in the course of the payor's trade or business, totaling \$600 or more in any calendar year. A "person engaged in a trade or business" includes not only those engaged for gain or profit, but also non-profit organizations, such as tax-exempt organizations and governmental bodies.

This requirement includes payments of \$600 or more for –

- Fees and other compensation for services.
- Commissions reduced by any repayment of current year's (but not prior year's) commissions.
- Interest and dividends. If the company pays dividends or is in the business of paying interest, the threshold is reduced to \$10 or more.
- Rents except for those paid to real estate agents. Rent paid by the real estate agent to the landlord is reportable gross (not net) of any commissions retained.
- Taxable prizes and awards paid in the course of business, such as by radio and television broadcasting companies, and incentive awards, such as those given to distributors by manufacturers.
- Fees paid for professional services to attorneys, physicians, and similar service providers.
- Royalties, annuities, pensions, and other gains, profits, and income.

This requirement does not apply to the following types of payments –

- Wages or other compensation reported on Form W-2.
- Payments of any type to corporations other than medical and healthcare payments and attorney fees.

- Payments of bills for merchandise, telephone, freight, storage, and similar charges. This exception does not apply when the merchandise is incidental to the receiving of services, such as auto or copier repairs from unincorporated providers.
- Payments to employees under an “accountable” plan of expense reimbursement.
- Salaries or profits paid or distributed by a partnership to the individual partners.
- Trust or estate payments to beneficiaries.
- Personal (non-business) payments for rent, interest, services, etc.
- Qualified achievement or safety awards of tangible personal property valued at \$400 or less.

Some other rules of note –

- For legal services, all payments of \$600 or more for legal services must be reported, even if the payments are to a corporation. For reporting purposes, it does not matter that the attorney retains only a portion of the payment as his or her fee, but that the payment is made to the attorney.
- Payments which included backup withholding must be reported on a 1099, regardless of the amount.
- Sometimes the structure of the business arrangement makes it difficult to determine when the payment was made. For information reporting purposes, amounts that are credited to, or set aside, for a taxpayer during a calendar year are constructively received and should be reported, although not actually received by the taxpayer. For this rule to apply, there must be no substantial limitation or restriction as to the time or manner of payment, or condition upon which payment is to be made. The amount payable must be available to the taxpayer so that he may draw it at any time and its receipt brought entirely within his own control and disposition.
- Where a payment is made in property other than money, the fair market value of the property at the time of payment is the amount subject to reporting.
- Direct sales of at least \$5,000 of consumer products sold to a buyer for resale, anywhere other than a permanent retail establishment, must be reported on Form 1099-MISC.
- Note that those who file 250 or more information returns are required to submit these forms electronically. Failure to comply with this requirement brings a significant penalty. We can assist you with this compliance.
- Rental activities that are considered a business should also consider filing Forms 1099. The IRS has said that failure to file Forms 1099 could jeopardize the position that the rental is a business; thus, the net income from this business would be subject to the 3.8% tax on net investment income.
 - **Action item.** Make sure that your company is in compliance with Form 1099 disclosure requirements. We can assist as needed.

Note: Penalties for failure to file correct information returns and/or to furnish correct payee statements have increased from prior year and are now subject to inflationary adjustments. There is no limitation on the penalties for intentional disregard to file. Information returns and payee statements include, for example, Forms 1098, 1099, W-2G, and W-2.

EMPLOYEES OR INDEPENDENT CONTRACTORS

It is critical that business owners correctly determine whether the individuals providing services are employees or independent contractors. Generally, you must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages paid to an employee. You do not generally have to withhold or pay any taxes on payments to independent contractors.

If you classify some of your workers as independent contractors who are actually employees, please note that the government continues to pursue these issues. Your business could be required to pay unpaid payroll taxes, interest, and penalties. Your company could also be obligated to pay for employee benefits that it did not previously provide, as well as federal penalties.

The basic guidance is an “economic realities test.” How much control does your company have over the way workers perform their jobs? For example:

1. Do the workers in question determine how they accomplish their task, or do you closely supervise them?
2. Do they have other clients, or do they work full-time for you?
3. Do they receive payment for each job, or do you pay them on your schedule?
4. Do they own their own equipment and facilities, or does your company provide equipment, supplies, and office space?

These and other considerations are important in determining a worker’s status. If you have any questions, consult with us about the proper classification of your workers to avoid additional taxes and penalties.

NEXUS

Are you sure that you aren’t doing business in new states? Talk with us if this may be the case. Note that states are increasingly aggressive at pursuing out-of-state businesses for sales/use and income taxes. Some indications that you may be doing business in that state include sending salespersons into that state, having payroll, leasing property, buying assets, etc.

- **Action item.** Consult with us if you have activity outside of your home state.

IDENTITY THEFT

We also want to ask you to please be careful and protect yourself and your business against the growing identity theft problem. Identity theft occurs when someone uses your identification information, like your name, Social Security Number, or credit card number without your permission to commit fraud or other crimes. They may acquire this information via data entry of your data on unsecure websites, getting insider information from businesses or organizations that may have your personal information, or by tricking you into releasing the information. We are also seeing fraudulent tax filings in the name of legitimate taxpayers in order to seize their tax refunds.

The United States Federal Trade Commission estimates that millions of Americans have their identities stolen each year. Please refer to the FTC web page to learn more on how to protect yourself from identity theft - <http://www.ftc.gov>.

One of the best ways to protect yourself is to use a credit monitoring service.

There are several good credit monitoring services available online that cost about \$150-\$200 per year. We think this is a small investment for highly needed protection.

LIFE INSURANCE

If your business has purchased and owns life insurance on employees, or is considering doing so, note that your business needs to comply with the “Notice and Consent” procedures. Failure to follow these rules can result in a future collection on the insurance policy becoming taxable income. Contact your insurance representative to make sure that this requirement has been addressed.

- **Action item.** If the company carries life insurance on any employee, consult with your life insurance agent to make sure that you are in compliance with the “notice and consent” rules.

DEPARTMENT OF LABOR UPDATE

The Department of Labor has increased the pay threshold for employees that are subject to overtime. Effective December 1, 2016, formerly exempt employees will be subject to overtime rules if their annual gross salary is less than \$47,476. Many employees may be subject to these new overtime rules. Please discuss with your HR consultant or employment attorney if you have additional questions.

SOCIAL SECURITY LIMIT FOR 2017

The Social Security wage maximum for 2017 increased to \$127,200; thus, you will need to make sure that your payroll software settings are adjusted for this limit in 2017.

PENSION LIMITS FOR 2017

Be sure that your payroll systems reflect these amounts; there are some changes from 2016. The 2017 amounts include –

- 401(k) or 403(b) maximum deferral - \$18,000 (plus additional catch-up of \$6,000 for those who turn age 50 or higher in 2016 and 2017).
- 401(k) maximum contributions from all sources in 2017 is \$54,000 (\$60,000 for those 50 or older).
- SIMPLE plans maximum deferral - \$12,500 (plus additional catch-up of \$3,000 for those age 50 or higher in 2016).

Consider whether your 401(k) plan should offer a Roth deferral option. For those who defer at the maximum amount, a Roth option allows the individual (economically speaking) to defer an additional amount represented by the tax on their deferral contribution.

Also, a new comparability profit sharing allocation plan can benefit small businesses by allowing owners to reach or approach the \$54,000 total contribution limit (\$60,000 with catch-up) for 2017 with less total required funding than a profit sharing plan that is integrated with social security or uses another allocation formula. *To make this change effective for 2016, your plan document would need to be amended by December 31, 2016. DMJ Wealth Advisors’ Qualified Plan Specialist, W. Brad Mann, JD, QPFC (bmann@dmjwa.com or 336.275.9886) can help you analyze whether this makes sense for you.*

FOREIGN BANK OR INVESTMENT ACCOUNTS

If you and/or any of your officers have any interest or signatory authority over any non-U.S. bank or investment accounts, please note that certain Treasury Department disclosures are probably required. The IRS has been aggressively auditing taxpayers in this area and penalties for non-compliance are significant. Foreign accounts include bank accounts, hedge funds, brokerage accounts, and other investments. Talk with us if you think that this requirement may apply to you. Please note that the due date has changed this year to April 15, 2017, with a six-month extension available.

TRAVEL PER DIEM RATES FOR 2017

The standard business mileage rate for 2017 is 53.5 cents per miles driven (compared to 54 cents for 2016).

The per diem travel rates for hotels has increased, but the rates for meals and incidentals are unchanged. These rates actually took effect on October 1, 2016.

The reimbursement rates are –

- High cost areas –
 - Lodging - \$214 (previously \$207)
 - Meals and incidental expenses - \$ 68 (unchanged)
- Low cost areas –
 - Lodging - \$132 (previously \$128)
 - Meals and incidental expenses - \$ 57 (unchanged)

For NC and adjoining states, the only designated high cost areas are the following –

NC	Kill Devil Hills (from June 1 to August 31)
VA	Washington DC metro area (year-round)
	Virginia Beach (from June 1 to August 31)
	Wallops Island (from July 1 to August 31)
SC	Charleston (March 1 to November 30)
TN	None

REDUCTION IN NC TAX RATES FOR “C” CORPORATIONS

On July 28, 2015, North Carolina Governor Pat McCrory announced the state had met the necessary revenue target for the fiscal year ended June 30, 2015, to lower the income tax rate for “C” corporations from 5 percent to 4 percent effective for tax years beginning on or after January 1, 2016.

NC UPDATE ON SALES TAX – REPAIR, MAINTENANCE, AND INSTALLATION SERVICES (RMI)

NC House Bill 1030 (HB 1030), effective January 1, 2017, will bring more changes regarding sales tax to business owners in real property trades or businesses. Most are aware of the sales tax changes that became effective March 1, 2016. Fewer taxpayers may know that sales tax changes in HB 1030 will eliminate or change dramatically some of these rules that just became effective March 1, 2016. *Stay tuned for more updates later from DMJ.* (Our recent update can be found at: <http://tinyurl.com/zsu2c2v> or NCDOR Notice E505 (09-16): <http://tinyurl.com/gsonenr>)

NC ESCHEATS

NC's Unclaimed Property Law requires all companies and institutions operating in the State to examine their books and other accounting records at the close of each fiscal year for non-life insurance companies (June 30) and calendar year (December 31) for life insurance companies to determine whether they are in possession of dormant unclaimed property. If so, the holder must first perform due diligence. This is the process that involves an attempt to locate rightful owners prior to escheatment. If unsuccessful in locating the owners, the holder is required to remit the property, along with a report, to the Department of State Treasurer. All holders (non-life insurance) must file their unclaimed property reports by November 1 of each year for the prior fiscal period. For more information, visit the State Treasurer website under Unclaimed Property tab (<http://tinyurl.com/jolj89n>).

- **Action item.** Review on an annual basis outstanding checks over a reasonable number of days and attempt to follow up with the payee. Consider remitting and reporting the payments to the State Treasurer if due diligence was not successful.

COMPENSATION PAID TO A NON-RESIDENT INDIVIDUAL OR NON-RESIDENT ENTITY FOR PERSONAL SERVICES PERFORMED IN NORTH CAROLINA

If you paid non-wage compensation of more than \$1,500 during the calendar year to a non-resident contractor for personal services performed in North Carolina, you may need to withhold NC taxes from their payment. The term "personal services" is not defined by NCDOR. However, income is generally derived in two ways: selling a product or providing a service. "Personal services" compensation is any compensation paid for providing a service. For purposes of the 4% withholding, the personal services subject to withholding are limited to personal services in connection with a performance, an entertainment or athletic event, a speech, or the creation of a film, radio, or television program.

COMPENSATION PAID TO AN ITIN CONTRACTOR IN NORTH CAROLINA

If you pay non-wage compensation of more than \$1,500 during the calendar year to an ITIN contractor, you must withhold North Carolina income tax at the rate of 4% from non-wage compensation. An ITIN contractor is a contractor who performs services in North Carolina for compensation other than wages and whose taxpayer identification number is an ITIN number instead of a social security number. An ITIN is issued by the IRS to a person who is required to have a taxpayer identification number, but does not have one and is not eligible to obtain a social security number. The ITIN is a nine-digit number that always begins with the number 9.

DMJ PORTAL IS AVAILABLE & TAX UPDATES

DMJ has a secure portal available for you to upload the electronic files that you need to send to us. Speak to your DMJ representative if you want to gain access to the portal.

Stay current with breaking tax news and little hints. Sign up at www.twitter.com/dmjandco. We also send firm updates by email – sign up by emailing us at contact@dmj.com.

Sincerely,

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