Late Tax Savings from Another Late Law

It might be worth filing an amended return.

BY JAMES D. KRICKETT

Once again, lawmakers waited until late in the year to pass another "extenders" bill. December's "Protecting Americans from Tax Hikes (PATH) Act of 2015" retroactively extended the 50 or so temporary tax provisions that are routinely extended on a one-or-two-year basis.

The so-called "Cadillac" tax on the high-cost health insurance plans so many podiatrists provide themselves and key employees will be delayed from 2018 to 2020. The PATH legislation also suspends the 2.3 percent excise tax on medical devices through 2017. A levy on health insurers will stop for one year.

Beginning with the Forms W-2, W-3, and returns for reporting non-employee compensation (e.g., Form 1099-MISC) filed for the 2016 tax year and later, PATH will require them to be filed on or before January 31. No longer will they be eligible for the extended filing date for electronically filed returns.

However, the big deal for many practicing podiatrists will be the permanent extension of the Section 179 small business expensing deduction.

First-Year Write-Offs

The so-called "Section 179" deduction allows a podiatry practice an up-front expense deduction for the entire cost of equipment ranging from computers and furniture to fixtures, vehicles, and medical devices. The amount allowed as a write-off in the first year (instead of slowly deducting or depreciating it over several years) is now permanently fixed at $500,000 per year (phased out dollar-for-dollar as expenditures begin to exceed an inflation adjusted $2,010,000 in a year).

In an unusual move, lawmakers treated air conditioning and heating units placed in service after 2015 as eligible for expensing. PATH also will allow these amounts to be permanently adjusted for inflation beginning in 2016.

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A Bonus Write-Off

Originally created as a short-term stimulus measure, bonus depreciation is back albeit phased out over a five-year period. Bonus depreciation, which permits the immediate deduction of any equipment expenses, rather than a depreciated tax benefit over time, has been extended at the former 50 percent rate for the 2015-2017 tax years, phased down to 40 percent in 2018 and 30 percent in 2019.

Making it even semi-permanent allows practices which spend heavily on equipment, machinery, and other property to reap large up-front tax breaks. Overall tax savings are predicted to be $281 billion over a 10-year period.

Many podiatry practices will find the bonus depreciation break to be more valuable than the Section 179 deduction because the Section 179 expensing deduction is limited to the taxable income of the practice with any excess carried forward. Naturally, losses generated by the 50 percent bonus depreciation can offset other income. They can also be carried back for two years, thereby generating a refund from Uncle Sam.

Writing Off Leasehold Improvements

Although few podiatry practices operate from what our lawmakers consider a "retail" building or fall into the category of restaurants, many podiatry professionals making improvements to leased property may benefit from PATH's new accelerated depreciation rules.

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Under now-permanent, special faster write-offs for qualified leasehold improvements, and qualified restaurant and retail improvement property, those so-called "improvements" may qualify for shorter 15-year recovery periods. That's right... PATH makes permanent a 15-year depreciable life for improvements made to restaurants and retail establishments, and to leased property. Without this unique write-off, many improvements would be depreciated over the much longer 39-year period associated with the building itself.

Increased Research Expense Credit

Overlooked and misunderstood by many podiatry professionals, the biggest provision in PATH is the "research and experimentation tax credit." According to many, it's the grand-daddy of all extenders, dating all the way back to 1981.

PATH now makes permanent the Section 41 much-maligned credit for increased research expenses—a direct reduction of the practice's tax bill rather than a deduction which merely reduces the income on which the tax bill is computed—for qualified research expenses. While market research and product testing do not qualify, all research in the laboratory or for experimental purposes does.

Fortunately, a podiatry practice can elect an alternative simplified research credit equal to 14 percent of the excess of the qualified research expenses for the tax year over 50 percent of the average research expenses for the three preceding tax years. If a practice has no qualified research expenses in any one of the three preceding tax years, the alternative simplified research credit is six percent of the qualified research expenses for the tax year for which the credit is being determined.

In addition to becoming a permanent fixture, the research credit has been modified so eligible practices and businesses with $50 million or less in gross receipts can claim the credit against their alternative minimum tax (AMT) liability. Also, some small businesses and professional practices can claim the credit against their payroll tax liability.

Note: Because the extension of the research credit is retroactive and includes amounts paid or incurred after December 31, 2014, podiatrists, such as those using a fiscal year and that already filed returns for a fiscal year that includes part of 2015, should consider filing an amended return to claim a refund for the amount of any taxes paid as a result of not claiming amounts now eligible for the credit.

Energy-Efficient Commercial Buildings

A provision in PATH extends through the 2016 tax year, the above-the-line deduction for the cost of energy-efficient improvements made to commercial buildings. A podiatry practice can get tax deductions for new or renovated buildings that save 50 percent or more of projected annual energy costs for heating, cooling, and lighting compared to model national standards, and partial deductions for efficiency improvements to individual lighting, HVAC and water heating, or envelope systems.

The tax deduction amount is up to $1.80 per square foot and is available to owners or tenants (or designers, in the case of government-owned buildings) of new or existing commercial buildings that are constructed or reconstructed to save at least 50 percent of the heating, cooling, ventilation, water heating, and interior lighting energy costs.

A partial deduction of $0.60 per square foot can be taken for improvements made to one of three building systems—the building envelope, lighting or heating, and the cooling system. The partial building improvement must reduce total heating, cooling, ventilation, water heating and interior lighting energy use by 16 2/3 percent (16 2/3% is the 50% goal of the three systems spread equally over the three systems).

On a related note, the American Society of Heating, Refrigerating, and Air-Conditioning Engineers (ASHRAE) standards required for the energy-efficient commercial buildings deduction have been updated in PATH. The provision modifies the deduction by updating the energy efficiency standards to reflect new standards of the American Society of Heating, Refrigerating and Air Conditioning Engineers beginning in 2016.

The Work Opportunity Tax Credit

PATH retroactively extended and greatly expanded the Work Opportunity Tax Credit (WOTC) through the 2019 tax year. The WOTC allows employers who hire members of certain targeted groups to get a credit against income tax of a percentage of first-year wages up to $6,000 per employee ($3,000 for qualified summer youth employees). In situations where the employee is a long-term family assistance (LTFA) recipient, the WOTC is a percentage of first and second year wages, up to $10,000 per employee.

While the maximum WOTC for a podiatry practice hiring a qualifying veteran is generally also $6,000, it can be as high as $12,000, $14,000, or $24,000, depending on factors such as whether the veteran has

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a service-connected disability, the period of his or her unemployment before being hired, and when that period of unemployment occurred relative to the WOTC-eligible hiring date.

The WOTC provision for employing veterans permanently extends the 20 percent employer wage credit for employees called to active military duty. Beginning in 2016, the provision modifies the credit to apply to employers of any size, rather than employers with 50 or fewer employees, as under the current rules.

WOTC also applies to employers who hire qualified long-term unemployed individuals (i.e., those who have been unemployed for 27 weeks or more) who begin work after December 31, 2015. The credit with such long-term unemployed individuals is 40 percent of the first $6,000 of wages.

The Built-In Gains of S Corporations

As the economy improves, many podiatry professionals are replacing much of their equipment and other business assets. Unfortunately, many are just discovering a corporate-level tax is being imposed at the highest marginal rate (currently 35%) on the so-called "built-in gain" of a podiatry practice operating as an S corporation. That built-in gain usually arose prior to the practice's conversion from a regular C corporation to an S corporation, and arises when assets are sold. PATH retroactively and permanently provides that, for determining the net recognized built-in gain, the recognition period is a five-year period—the same period that applied to tax years beginning in 2014.

In other words, the built-in capital gains of a corporation which has become an S corporation must be held for five years in order to avoid a conversion capital gains tax. Permanently reducing the S corporation recognition period for the built-in gains tax will make it easier for incorporated practices to become S corporations and more fluidly change the status of their practice entity to respond to changing market conditions.

Professional Education

While the tax breaks for the cost of continuing professional education were left untouched by PATH, the new law does extend through 2016 the above-the-line deduction for qualified tuition and related expenses for higher education. The deduction is capped at $4,000 for an individual whose AGI does not exceed $65,000 ($130,000 for joint filers) or $2,000 for an individual whose AGI does not exceed $80,000 ($160,000 for joint filers).

Generally, an individual's gross income doesn't include any amount received as a qualified scholarship by a candidate for a degree at an educational organization. Unfortunately, the exclusion doesn't usually apply to any part of the amount that represents payment for teaching, research, or other services (sometimes referred to as the "payment-for-services rule").

Earlier tax law contained exceptions to the payment-for-services rule for amounts received by an individual under either the National Health Service Corps Scholarship program or the Armed Forces Health Professions Scholarship and Financial Assistance program. Thanks to PATH, amounts received in tax years beginning after 2015 that include payments from certain work-learning-service programs that are operated by a work college will be exempt from an individual's gross income.

Making SIMPLE Simpler

Many small practices (those with fewer than 100 employees) cannot afford or do not want to maintain a traditional 401(k) plan. The tax system has a (usually low cost or free) alternative called the SIMPLE IRA. A SIMPLE IRA works much like 401(k)s, with an employer contribution and elective deferrals done by workers.

PATH permanently allows rollovers from 401(k) plan balances to SIMPLE IRA balances, provided the SIMPLE IRA plan has been open at least two years. This immediately makes these plans more attractive for small practices and businesses, even startups, to pursue.

Correcting or amending any tax return because of errors, omissions, mistakes, overlooked deductions, or ignored retroactive law changes is both necessary and encouraged by the IRS.

Penalty-Free Mistakes

Except in situations where there is reasonable cause with no willful neglect and subject to certain other exceptions, any failure to include all of the information required on an information return or a payee statement, or any inclusion of incorrect information on an information return or payee statement, is subject to a penalty. The amount of the penalty usually depends on a number of factors, including whether the payor is a small business or practice.

The new PATH law establishes a safe harbor from penalties for the failure to file correct information returns and for the failure to furnish correct payee statements. Generally, if the error is $100 or less ($25 or less in the case of errors involving tax withholding), the issuer of the information return is not required to file a corrected return and no penalty is imposed.

Under the exception to this rule, should any person receiving payee statements request a corrected statement, the penalty for failure to file a correct information return and the penalty for failure to furnish a correct payee statement would continue to apply even in the case of de minimis errors. These provisions are effective for returns and statements required to be filed after Dec. 31, 2016.

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Reaping Retroactively

Correcting or amending any tax return because of errors, omissions, mistakes, overlooked deductions, or ignored retroactive law changes is both necessary and encouraged by the IRS. Generally, a podiatry practice, or its principal, can change their mind about a previously filed tax return within three years from the time the return was filed, or within two years from the time the tax was fully paid, whichever is later. If the refund claim involves the deductibility of bad debts or worthless securities, the period is seven years.

Individuals, sole practitioners, etc., use Form 1040X, Amended Individual Tax Return. A corporation that filed Form 1120 uses Form 1120X, Amended U.S. Corporation Income Tax Return, to file an amended return, while S corporations and partnerships check a box on the Form 1120S or Form 1065.

More Extended Deductions

There are, of course, quite a few more tax-saving provisions, many of them quite narrow in scope such as those for film and theater producers, NASCAR racetrack owners, racehorse owners, and rum producers in Puerto Rico and the Virgin Islands, all included as part of PATH.

Apparently, the IRS has proved unable to audit large partnerships. That growing class of entities was reportedly escaping scrutiny. By scrapping the existing audit strategies and shifting many responsibilities to partners and their counsel, lawmakers earlier responded to the IRS's inability to do this oversight on its own. Section 274 of PATH corrects and clarifies certain technical issues in partnership audit enacted in the Bipartisan Budget Act of 2015.

PATH permanently extended the maximum monthly amount that can be excluded for transit passes and van pool benefits so that these transportation fringe benefits match the exclusion for qualified parking benefits. These fringe benefits are excluded from an employee's wages for payroll tax purposes and from gross income for income tax purposes.

The complexity, the fact that many of its provisions apply to transactions occurring in 2015, and the uneven expiration date for many of these tax benefits make professional assistance almost mandatory, at least if the podiatry practice hopes to reap its share of the $622 billion in tax savings. **PM**

James D. Krickett is a well-known tax and financial adviser whose columns are syndicated to more than 65 publications each week. His features routinely appear in the pages of leading trade magazines and professional journals.