LUTZ AND CARR
CERTIFIED PUBLIC ACCOUNTANTS, LLP
300 EAST 42ND ST., NEW YORK, NY 10017
212-697-2299 Fax 212-949-1768

2016/2015

Annual Business Income Tax Update

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JANUARY 2016

On December 18, 2015 the President signed the Protecting Americans from Tax Hikes Act of 2015 (the "PATH Act") into law. This law extends various provisions of the Internal Revenue Code and made other temporary provisions permanent for certain tax years. This memo provides information relevant to the majority of our clients for the 2015 and 2016 tax years, as modified by the PATH Act. Please feel free to contact members of our staff for help with your questions.

1) PATH Act Permanent Provisions

A. Code Sec. 179 Small Business Expensing

The PATH Act permanently retains the 2014 limits for Section 179 expensing. Business and self-employed individuals can elect to expense up to $500,000 of certain property placed in service during the year. The deduction is phased out on a dollar-for-dollar basis when property placed in service exceeds $2,000,000. The deduction can only be claimed to the extent the taxpayer has business income. Starting in 2016, the higher expense limitation and phase-out amounts will be indexed for inflation. The PATH Act also eliminates the $250,000 limitation for expensing qualified real property improvements, thus increasing the amount that can be taken for these types of costs to $500,000, subject to future increases for inflation.

B. Qualified Leasehold/Retail Improvements, Restaurant Property

The provision for a 15-year recovery period for qualified leasehold improvements, qualified retail improvements and qualified restaurant property was made permanent by the PATH Act.

C. Credit for Increasing Research Activities (a/k/a the R&D Credit)

The R&D tax credit applies to increased business spending on research. This credit is available for up to 20 percent of the excess of an eligible taxpayer's qualified research expenses over a base amount plus 20 percent of the taxpayer's qualified basic research payments, plus 20 percent of the taxpayer's payments to a qualified energy consortium for energy research. The base period is generally the average of the preceding four tax years.

Beginning in 2016, eligible small businesses ($50 million or less in gross receipts) may apply the credit against the alternative minimum tax and certain small businesses can apply the credit against the employer share of Social Security and Medicare taxes.

D. Gain Exclusion on Sale of Small Business Stock

You generally can exclude from your income up to 50% of your gain from the sale or trade of qualified small business stock held by you for more than 5 years. The exclusion can be up to 75% for stock acquired after February 17, 2009, and no later than September 27, 2010, and up to 100% for stock acquired after September 27, 2010, and before 2014.

E. Reduction in S Corporation Recognition Period for Built-In Gains

The period for which an S corporation must hold its assets following a conversion from a C corporation in order to avoid the tax on built-in gains on its assets is permanently reduced to five years. Previously, this period was ten years.

2) PATH Act Temporary Extensions

A. Bonus Depreciation

Bonus depreciation was extended through December 31, 2019. The applicable bonus depreciation percentages are 50% for 2015, 2016 and 2017, 40% for 2018 and 30% for 2019.

B. Expensing of Film, Television and Theatrical Production Costs

Effective for tax years beginning on or after January 1, 2016, live theatrical productions are now eligible to take advantage of this provision.

The provision allowing the first $15,000,000 of the cost of producing a qualified film or television program to be deducted rather than capitalized was extended through December 31, 2016. A film or television production is qualified if at least 75% of the compensation is for services paid in the United States.

3) Other Relevant Business Income Tax Provisions - Federal

A. Repair Regulations

Effective for tax years beginning on and after January 1, 2014, the IRS has promulgated regulations addressing the treatment of repairs and maintenance, asset acquisitions and capital improvements. The following selected provisions of the repair regulations apply to the majority of our clients:

1. ***De minimis*** **safe harbor for expensing asset acquisitions.** For 2016 and 2015, business taxpayers that issue audited financial statements can annually elect to directly expense items costing $5,000 or less. For 2015 business without an audited financial statement can elect to expenses items costing $500 or less. For 2016, the limit for businesses without an audited financial statement increases to $2,000.

2. **Routine maintenance safe harbor**. Amounts paid for maintenance are deductible if the taxpayer reasonably expects to perform the maintenance more than once during its defined useful life for tax purposes. For building and related “systems” (plumbing, electrical, HVAC, etc..), the taxpayer must reasonably expect to perform the maintenance more than once during the 10-year period beginning when the building or related system was placed in service.

3. **Safe harbor for taxpayer with small building**. Taxpayers with $10,000,000 or less in annual gross receipts can make an annual election to expense improvements if the amount paid for all improvements during the year does not exceed the lesser of $10,000 or 2% of the building’s unadjusted basis. The election can be made for each building owned by the taxpayer that has an unadjusted basis of $1,000,000 or less.

   Other provisions of the repair regulations are also in place and certain changes under the regulations require a formal change of accounting method to be filed with the IRS. Please contact us if you have additional questions or concerns on this topic.

B. Small Business Health Insurance Tax Credit

A tax credit for the cost of health insurance premiums for small businesses and small tax-exempt organizations continues to be available. The maximum credit is 50 percent of eligible health insurance premiums for plans started after 2013 for small businesses and 35 percent for nonprofits. In order to qualify, you must have 25 or fewer full time equivalent employees whose average wages are less than $51,600. There is a phase-out of the credit for wages between $25,800 and $51,600. Since the basis for this credit is the number of "full time equivalent" employees, you could still qualify if you employ more than 25 employees, but some of them are part-time. The credit is computed on Form 8941 and included in the general business credit. Nonprofits also compute the credit on Form 8941and report the amount of the credit on Form 990-T. This is a refundable credit which means that even if you have no tax you will be refunded the amount of the credit. The credit can only be taken for two consecutive years.

4) Other Relevant Business Income Tax Provisions - New York State and New York City

A. Reductions in Corporate Income Tax Rates

a. New York State

Starting with tax years beginning on or after January 1, 201***6*** the corporate income tax for C-corporations will drop to 6.5% (from the current rate of 7.1%). The rate for qualified manufacturers will be 0% for years beginning on or after January 1, 2014 and will be 5.9% for qualified emerging technology companies (with additional reductions for technology companies doing business in New York State through 2018).

b. New York City

Starting with tax years beginning on or after January 1, 201***5***, the tax rate for C-corporations with less than $1,000,000 of NYC business income will drop to 6.5% (from the 2014 rate of 8.85%). A smaller reduction for C-corporations with NYC business income between $1,000,000 and $1,500,000 or overall business income (i.e. inside and outside of NYC) between $2,000,000 and $3,000,000 also applies.

For manufacturing corporations with less than $10,000,000 of NYC business income, the tax rate for C-corporations will drop to 4.425% (from the 2014 rate of 8.85%). A smaller reduction for manufacturing corporations with NYC business income between $10,000,000 and $20,000,000, or overall business income (i.e. inside and outside of NYC) between $20,000,000 and $40,000,000 also applies.

B. Reductions in the Tax on Capital

a. New York State

Starting with tax years beginning on or after January 1, 201***6***, the tax on business capital for C-corporations will phase-out from the current rate of .15% (.04% for co-ops) of the corporation's average capital to an eventual rate of 0% for tax years beginning on or after January 1, 2021.

b. New York City

Starting with tax years beginning on or after January 1, 201***5***, the NYC tax on capital is effectively eliminated for C-corporations with a computed tax on capital of $10,000 or less. A $10,000 reduction in this tax applies to all capital tax calculations.

C. Greater Allowance of Net Operating Loss Carrybacks

New York State and New York City

For losses incurred in tax years beginning on or after January 1, 2015, C-corporations can carry back a net operating loss (or "NOL") to the three years prior to the loss year. In addition, NOL's are no longer limited to the amount allowed for federal income tax purposes and carrybacks are not limited to $10,000.

D. Increases in the MTA Surcharge

For tax years beginning on or after January 1, 2015, the MTA surcharge rate will increase to 25.6% (the current rate is 17%) of the New York State corporate tax. For years beginning on or after January 1, 2016, the rate will be adjusted by the New York tax department.

E. Bright-line Test for Filing New York Corporate Tax Returns and Paying New York Corporate Tax

For tax years beginning on or after January 1, 2015 a corporation organized in a state other than New York will be required to file a New York corporate income tax return (and pay New York corporate income tax, as applicable) if its New York sourced gross receipts are $1,000,000 or more (determined under the "market-based" approach, generally meaning the location of the customer). The current law only requires a non-New York corporation to file a return and pay tax if it has physical presence (e.g. an office and/or employees) in the State.

Similarly, a corporation will be deemed to be doing business in the MTA district if its gross receipts sourced to the district are $1,000,000 or more.

F. Elimination of NYC Alternative Tax

For tax years beginning on or after January 1, 2015, the NYC alternative tax on income plus shareholder compensation is repealed for C-corporations only (not for S-corporations doing business in NYC).

G. New NYC Corporate Income Tax Forms

Starting with the 2015 tax year, C-corporations doing business in NYC will report their income and NYC corporate tax on new NYC-2 series forms. S-corporations doing business in NYC will continue to use the existing NYC-3 series forms.