Last chance for deductions

How tax laws are changing for small and midsize businesses

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At this point last year, Congress was debating a "fiscal cliff" deal that included the elimination of Bush-era tax cuts and several tax provisions favorable to businesses. Many of those provisions, extended for 2013, are now due to expire unless further action is taken.

"Based on what has occurred in Congress recently, I can't say I'm optimistic that a lot will be accomplished," says Terry Silver, CPA, J.D., a partner at Skoda Minotti.

Smart Business spoke with Silver about expiring tax provisions that affect owners of small and midsize businesses.

What key tax provisions are set to expire?

From a business standpoint, most are related to depreciation. Other changes impact individuals, but for businesses the important one is the Section 179 deduction for tangible personal property. For 2013, you can expense up to $500,000 for property placed into service during the year. That starts to phase out if you have property additions of more than $2 million, and basically doesn't apply once you reach $2.5 million. At that point, you must capitalize purchases of property and equipment and depreciate them over a period of years. That taxpayer-friendly treatment is substantially reduced in 2014 to $25,000, with the phase-out limit falling to $200,000.

Taxpayers can claim Section 179 write-offs for qualified real property as part of that $500,000. You can write off up to $250,000 in qualified leasehold improvements.

Another favorable provision in 2013 is bonus depreciation, which doesn't contain the taxable income limitations and phase-out provisions attached to Section 179. This 50 percent bonus depreciation allows half of the cost to be expensed without limitations. The only restriction is that it has to be original use with the taxpayer; it doesn't cover used equipment. Bonus depreciation also is going away in 2014, except for certain aircraft and long production period property.

One other tax provision extended through 2013 is the research tax credit. If your business spends money on research and development (R&D), there's a tax credit for increasing expenditures related to that activity.

Any chance these might be extended?

Section 179 and bonus depreciation have been extended a number of times in recent years. Given the concerns about the economy, there's some likelihood that something will be accomplished. While it doesn't seem likely to happen by the end of the year, it is possible an extension could be put in place in 2014, retroactive to 2013. The most apt to return is the R&D credit, which has been extended numerous times.

Is it too late to take advantage of these expiring provisions?

With some of these, a business may be looking at equipment purchases planned for 2014 and accelerate a purchase to the end of 2013. It is important to note that the property must not only be purchased, but placed in service before the end of the year.

There also are other strategies business owners can follow to reduce their tax burden. Many small business owners, for whatever reason, don't have a retirement plan. If you put in a profit-sharing plan with a 401(k) feature, careful planning can allow a significant amount of the employer contribution to be skewed toward the owner.

Depending on the nature of your business, you might consider paying out bonuses. But be careful to remember the new additional 0.9 percent Medicare tax related to earned income over $250,000 for couples filing jointly, $200,000 for single taxpayers.

If you're the owner of an S corporation with a $250,000 salary and have substantial profit for the year, you may want to consider taking distributions in lieu of additional salary. Although the shareholder will still pay income tax on the profits, the 1.45 percent Medicare tax paid as an employee, the 1.45 percent paid by the company and additional 0.9 percent Medicare tax can be avoided. However, the IRS may look at distributions relative to the salary you're taking — the salary has to be reasonable for the services you provided.

Overall, as 2013 winds down and we head into 2014, owners and executives in the highest tax brackets will face higher tax rates on taxable income, qualified dividends and a 3.8 percent tax on net investment income. Whether Congress passes legislation to provide tax relief and spur the economy will no doubt be a topic of much debate.