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Enhance Your Wealth With Targeted Tax Strategies

Presented by: Lou Rendon, CPA, MBT

Before we get started …

- Handout
  - Download from lower left corner on screen
- Q&A
  - Post your question in the chat pod on the left side of screen
  - Time available at the end

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Today's Theme

- Utilize various tax rules, elections, and strategies
- Mitigate income tax
- Enhance your after-tax corporate and personal wealth

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Tax Accounting Methods

We have seen many instances where a Contractor did not effectively select a favorable and allowable tax accounting method that could have resulted in the deferral of income, thereby mitigating the financial cost of income taxes and making such funds available for business growth and wealth growth.

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Tax Accounting Methods for Contractors

A) In general, for revenues of $5,000,000 or less the **Cash Basis** tax method of accounting can and should be utilized. This method allows for the recognition of income and thus the payment of taxes when cash flow should be available to do so.

Also, through the proper management of year end cash flow, taxable income and income taxes can be effectively deferred and thus allow for business use of such cash flow for growth.

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S-Corporations are not subject to the $5,000,000 revenue limitation and can use the Cash Basis Method up to $10,000,000 in revenues.

In many cases we have seen small businesses too liberally elect to simply use the Accrual Basis Method of Accounting, thus barring themselves from the more favorable and effective Cash Basis.

A subsequent attempt to change the election is a very extensive process that requires IRS approval, not likely to occur.

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B) Completed Contract Method of Accounting.

As the method's name indicates, profit is not recognized until the job is completed.

This method should generally allow for the deferral of profit recognition until such point in time as the contract's cash flow has been received. And even more favorably, the use of the job's cash flow can occur for an extensive length of time before the job is completed and profit recognized.

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C) For Revenues of $10,000,000 and above, long term contracts have to be accounted for under the **Percentage of Completion** Method of Accounting for tax purposes.

Under this set of circumstances, a long term contract is a contract that begins in one tax year and is completed in a subsequent tax year.

However, what is very important to understand is that for all "<u>non</u>" long term contract activity, i.e., short term contracts and non job related payables for example, the original tax accounting method (cash or completed contract) is still able to be utilized.

This often misunderstood circumstance can still provide significant tax deferral opportunities as well as Cash Flow and Wealth Preservation.

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D) Tax Reporting of Retentions.

If a small Contractor has unfortunately elected the Accrual Method of Accounting for tax purposes, there is some relief available.

In certain circumstances, the Retentions Receivable and Payable of a contract can be deferred until all conditions of performance are met and the remaining amount becomes billable or payable.

This strategy should result in a Net Receivable position where income recognition can be deferred until the job's completion and perhaps beyond.

This is a very specialized IRS procedure and requires careful analysis to determine its applicability.

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In summary, the tax accounting methods available to a Contractor are very unique and should be evaluated carefully before determining which method should be utilized.

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Deductions and Credits

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IRS Section 179 Depreciation

Under the current tax rules for 2016, up to $500,000 of new or used equipment purchases can be elected to be deducted 100%! However, the 179 deduction is limited to the extent of your Business' Taxable Income. As such a tax loss cannot be created by a 179 deduction. Therefore, this requires special planning.

The $500,000 deduction level was made permanent by Tax Legislation passed with the "PATH" Tax Act of 2015.

Note: This "permanent" tax rule can be changed, repealed, etc., should Congress and the President decide to do so!

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IRS Section 168 Bonus Depreciation

Under the Tax Act of 2015, new property purchased can elect to have 50% of its purchase price deducted in the year of purchase.

If purchases are being contemplated, it may be prudent to do so in 2016 or 2017 rather than waiting until 2018, because the 50% level decreases to 40% in 2018 and then 30% in 2019. Beginning in 2020, the Bonus Depreciation Election is gone!

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Cost Segregation

This is a procedure in which personal property assets are identified and separated out of the Acquisition of Real Property, typically a building.

Such separately identified Personal Property Assets can then be depreciated over 5-, 7- or 15-year lives, rather than the 39-year life for real property.

A cost segregation project can significantly decrease and defer your income tax cost, thus increasing cash flow and your net worth.

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Research & Development (R&D) Tax Credits

For Contractors some of their efforts that could qualify for this tax credit include:

- Analyzing a design function and improving its performance, reliability, quality, safety, etc.
- Analyzing certain construction means, methods and techniques
- Developing and/or improving construction equipment, etc.

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The R&D Tax Credit most often is utilized to offset California State Income Tax. However, beginning in 2016, the Tax Act of 2015 has liberalized the opportunity for this credit to be able to offset Federal Income Tax.

Our next webinar on Thursday, November 17th will be dedicated to this R&D Tax Credit opportunity.

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Estate Tax Planning Matters

Under current tax rules the amount that can be gifted and bequeathed without incurring a tax cost is $5,450,000 per person for the 2016 tax year.

Going into the 2017 tax year, pending the outcome of the Presidential election, there have been certain discussions that the above exemption amount could be reduced to only $1,000,000!

Therefore, the prudent thought is that if a gift of wealth is being contemplated, it may be wise to consummate such transactions in 2016 rather than risk an adverse change to the favorable current tax rules.

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Grantor Retained Annuity Trust (GRAT):

This is an Estate Tax Planning Strategy that we have used successfully to transfer the Ownership Value in Real Estate and Closely Held Businesses for clients.

Essentially, the Asset Owner makes a gift to the GRAT of the Asset. The Future Value of the Gifted Asset goes to the Trust Beneficiary upon the expiration of the Trust. The current gift value that goes into the Trust is usually at a Discounted Value. The Asset Owner also is able to retain an Income/Cash Flow Stream for a certain period of years.

Overall, the strategy provides the ability to transfer significant wealth while minimizing – if not mitigating – any Gift or Estate Tax, thereby preserving the owner's original wealth, and allowing the Asset's future value to pass tax-free to the heirs.

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Employee Stock Ownership Plans (ESOP):

An ESOP is actually a form of Qualified Pension Plan. The Plan's purpose is to acquire the Current Owner's Stock Interest, in whole or in part.

One of its advantages is that an ESOP can create a Market to purchase Stock that is often severely limited due to Finances and Lack of Marketability.

By utilizing an ESOP an Owner can manifest the Value of his Construction Business that all too often faces liquidation and dissolution after the end of the Owner's tenure.

Also, if structured properly, the Purchase of the Owner's Stock Interest can be done with Corporate Pre Tax Dollars. Further, the Owner personally can defer their income tax cost by reinvesting their proceeds appropriately.

From a Wealth Planning perspective, an ESOP can create a current and future Market Value for a Construction Company that might not otherwise exist or even be available.

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Frazer, LLP's Webinar Series for Contractors

November 17, 2016

Take Advantage of Tax Credits

Are you aware of research and development (R&D) incentive programs? Are you taking full advantage of the R&D Tax Credit? Attend this webinar and learn about the broad range of common construction industry practices that qualify for the credit and how to claim the credits you deserve.

Presented by: alliantgroup

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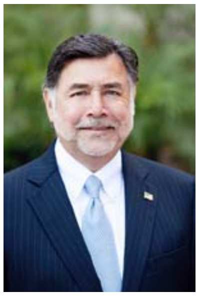

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- Estate tax and gifting strategies
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- Proactive, up-front planning
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- Research tax credits
- Succession and transition planning
- Wealth preservation and retirement planning

Consulting and Business Advisory Services:
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- Cost segregation studies
- Entity selection
- Lease or buy consulting
- Loan packaging and debt restructuring
- Tax deferred exchanges