C. J. Babbit, CPA, Inc.
frontdesk@cjbabbitcpa.com

2222 Shadowlake Drive Oklahoma City, OK 73159 (405) 691-4567 FAX (405) 691-4599

Tax & Business Alert

MAY 2017

COULD A COST SEGREGATION STUDY SAVE YOUR COMPANY TAXES?

If your business has acquired, constructed or substantially improved a building recently, consider a cost segregation study. One of these studies can enable you to identify building costs that are properly allocable to tangible personal property rather than real property. And this may allow you to accelerate depreciation deductions, reducing taxes and boosting cash flow.

OVERLOOKED OPPORTUNITIES

IRS rules generally allow you to depreciate commercial buildings over 39 years (27½ years for residential properties). Often, businesses will depreciate structural components (such as walls, windows, HVAC systems, elevators, plumbing and wiring) along with the building.

Personal property — such as equipment, machinery, furniture and fixtures — is eligible for accelerated depreciation, usually over five or seven years. And land improvements — fences, outdoor lighting and parking lots, for example — are depreciable over 15 years.

Too often, companies allocate all or most of a building's acquisition or construction costs to real property, overlooking opportunities to allocate costs to shorter-lived personal property or land improvements. Items that appear to be part of a building may in fact be personal property. Examples include:

- Removable wall and floor coverings,
- Detachable partitions,
- Awnings and canopies,
- Window treatments,
- Signage, and
- Decorative lighting.

In addition, certain items that otherwise would be treated as real property may qualify as personal property if they serve more of a business function than a structural purpose. Examples include reinforced flooring to support heavy manufacturing equipment, electrical or plumbing installations, and dedicated cooling systems for server rooms.

A STUDY IN ACTION

Let's say you acquired a nonresidential commercial building for $5 million on January 1. If the entire purchase price is allocated to 39-year real property, you're entitled to claim $123,050 (2.461% of $5 million) in depreciation deductions the first year.

IT MAY NOT BE TOO LATE: LOOK-BACK STUDIES

If your business invested in depreciable buildings or improvements in previous years, it may not be too late to take advantage of a cost segregation study. A "look-back" cost segregation study allows you to claim missed deductions in qualifying previous tax years.

To claim these tax benefits, we can help you file Form 3115, "Application for Change in Accounting Method," with the IRS and claim a one-time "catch-up" deduction on your current year's return. There will be no need to amend previous years' returns.

A cost segregation study may reveal that you can allocate $1 million in costs to five-year property eligible for accelerated depreciation. Reallocating the purchase price increases your first-year depreciation deductions to $298,440 ($4 million × 2.461%, plus $1 million × 20%).

IMPACT OF TAX LAW CHANGES

Bear in mind that tax law changes may occur this year that could significantly affect current depreciation and expensing rules. This in turn could alter the outcome and importance of a cost segregation study. Contact our firm for the latest details.

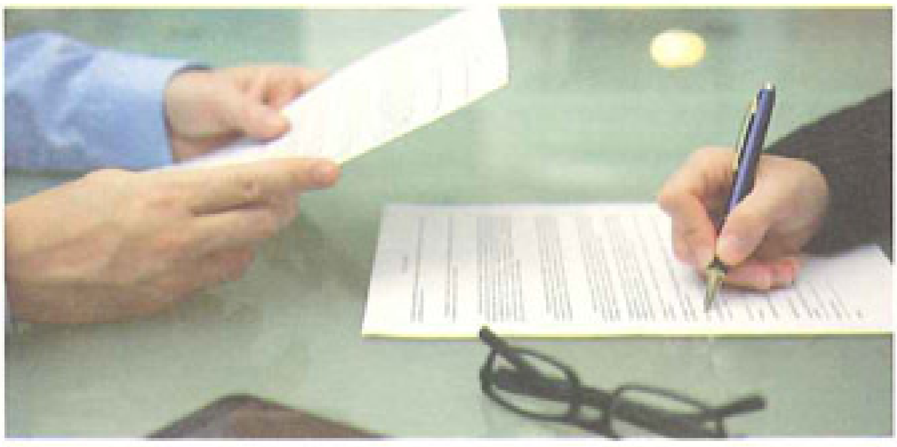
On the other hand, any forthcoming tax law changes likely won't affect your ability to claim deductions you may have missed in previous tax years. (For more on this concept, see "It may not be too late: Look-back studies" above.)

WORTHY EFFORT

As you might suspect, a cost segregation study will entail some effort in analyzing your building's structural components and making your case to the IRS. But you'll likely find it a worthy effort. ■

VIATICAL SETTLEMENTS: A FUNDING MECHANISM FOR MEDICAL COSTS

Someone who's terminally or chronically ill may lack the funds to cover significant medical costs. Although insurance policies have historically been held for the death benefits, it may be possible to sell a policy to a viatical settlement provider. This way, the individual can secure much-needed and generally tax-free cash while still alive.



BUYERS AND SELLERS

Viatication allows a terminally ill person to sell an existing life insurance policy to an investor for more than its cash surrender value but less than its net death benefit. The buyer continues to pay the premiums and receives the life insurance proceeds upon the death of the insured. Many companies currently either buy the policies themselves or serve as brokers to match buyers and sellers for a fee.

In identifying a potential seller, many viatical companies limit their selection to terminally ill individuals with a certain remaining life expectancy (for example, 24 months or less). This is because the company wants to minimize its risk that the individual will outlive his or her life expectancy, resulting in a lower return from the purchase of the life insurance policy for the company.

FACTORS TO CONSIDER

To determine whether it would be advantageous to sell a policy, the insured should consider factors such as:

- His or her cash needs,
- The discount in the value of the death benefit,
- The possibility that payments will disqualify him or her for Medicaid benefits, and
- Access to the payments by his or her creditors.

(Regarding the last point, the cash value while it remains in a life insurance contract may not be subject to the claims of creditors.)

SO YOU JUST FILED YOUR TAXES — COULD AN AUDIT BE NEXT?

Like many people, you probably feel a great sense of relief wash over you after your tax return is completed and filed. Unfortunately, even professionally prepared and accurate returns may sometimes be subject to an IRS audit.

The good news? Chances are slim that it will actually happen. Only a small percentage of returns go through the full audit process. Still, you're better off informed than taken completely by surprise should your number come up.

RED FLAGS

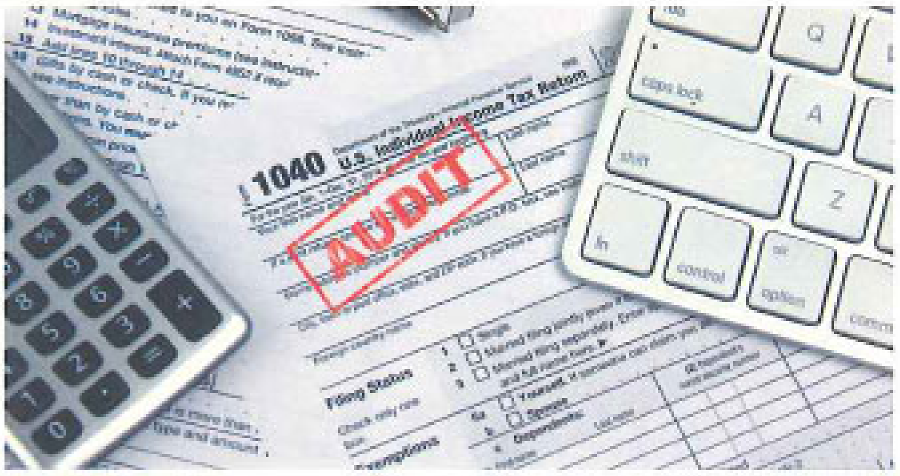
A variety of red flags can trigger an audit. Your return may be selected because the IRS received information from a third party — say, the W-2 submitted by your employer — that differs from the information reported on your return. This is often the employer's mistake or occurs following a merger or acquisition.

In addition, the IRS scores all returns through its Discriminant Inventory Function System (DIF). A higher DIF score may increase your audit chances. While the formula for determining a DIF score is a well-guarded IRS secret, it's generally understood that certain things may increase the likelihood of an audit, such as:

- Running a traditionally cash-oriented business,
- Having a relatively high adjusted gross income,
- Using valid but complex tax shelters, or
- Claiming certain tax breaks, such as the home office deduction.

Bear in mind, though, that no single item will cause an audit. And, as mentioned, a relatively low percentage of returns are examined. This is particularly true as the IRS grapples with its own budget issues.

Finally, some returns are randomly chosen as part of the IRS's National Research Program. Through this program, the agency studies returns to improve and update its audit selection techniques.



CAREFUL READING

If you receive an audit notice, the first rule is: Don't panic! Most are *correspondence* audits completed via mail. The IRS may ask for documentation on, for instance, your income or your purchase or sale of a piece of real estate.

Read the notice through carefully. The pages should indicate the items to be examined, as well as a deadline for responding. A timely response is important because it conveys that you're organized and, thus, less likely to overlook important details. It also indicates that you didn't need to spend extra time pulling together a story.

YOUR RESPONSE (AND OURS)

Should an IRS notice appear in your mail, please contact our office. We can fully explain what the agency is looking for and help you prepare your response. If the IRS requests an in-person interview regarding the audit, we can accompany you — or even appear in your place if you provide authorization. ■

TAX CALENDAR

April 18

- Besides being the last day to file (or extend) your 2016 personal return and pay any taxes due, 2017 first quarter estimated tax payments for individuals, trusts and calendar-year corporations are due today. So are 2016 returns for trusts and calendar-year estates and C corporations, plus any final contribution you plan to make to an IRA or Education Savings Account for 2016. Simplified Employee Pension and Keogh contributions are also due today if your return isn't being extended.

June 15

- Second quarter estimated tax payments for individuals, trusts, and calendar-year corporations are due today.

C J BABBIT CPA
2222 SHADOWLAKE DR
OKLAHOMA CITY, OK 73159-7440

5 GROWTH STRATEGIES FOR TODAY'S BUSINESSES

It's probably safe to say that nearly every business owner wants his or her company to grow. The question is: How? As you ponder your company's ideal strategic direction, here are five common business growth strategies to consider:

1. Creating and delivering new products and services. This is probably the most obvious growth strategy, but that doesn't mean it's easy. Conduct market research to determine not only which new products and services will appeal to your customers, but also which ones will be profitable.

2. Tapping into new markets and territories. The idea here is to market and sell your existing products and services to different customer niches or to customers in different geographic areas. Extensive market research is again one of the keys to success for this growth strategy.

3. Penetrating your existing markets. This strategy involves selling more of your existing products and services to your current customers. Start by performing a market segmentation analysis to determine which customers to target with marketing messages designed to increase specific product and service sales.

4. Developing new sales and delivery channels. The Internet is the best example of a new sales and delivery channel for products and services. Talk with your sales and marketing executives about ways you can use the Internet or another alternative channel to grow your sales and revenue.

5. Mergers and acquisitions (M&A). Growing through M&A is very different from the other, more organic growth strategies we've covered. This strategy can result in rapid growth literally overnight, as well as the realization of valuable synergies between the merged companies. But performing thorough due diligence on acquisition candidates is absolutely key to successful growth via M&A. ■