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For Small Businesses and Entrepreneurs, Some Welcome Clarity

By PAUL J. LIM FEB. 19, 2016

Small-business owners, who often consider taxes among their biggest concerns, didn't get major new tax breaks this year. But they have gotten something else: greater clarity about deductions and credits, which should help their planning for 2016.

In December, Congress passed the Protecting Americans From Tax Hikes Act, which enhanced and made permanent several tax provisions that Congress had been renewing haphazardly in previous years. Some of those provisions were extended retroactively late in the year, which made it difficult to make informed decisions about long-term purchases and investments.

"What's ironic is that there's very little in the PATH Act that's new," said Paul Gevertzman, a tax partner at Anchin, Block & Anchin L.L.P. in New York. "Yet it's fantastic for small-business owners because it does away with all the uncertainty they've been living with for the past few years."

Take the research and development credit, which the PATH Act made permanent.

While it may sound as though this credit applies only to companies that are scientific in nature, "that's actually not true," said Jonathan Medows, a certified public accountant in New York who works with small businesses and freelancers. "It could be for companies developing new software, but it could also be for bakeries developing new recipes."

One such company is Doughnut Plant, a Lower East Side bakery with trademarked jelly-filled square doughnuts and a cult following.

The owner, Mark Isreal, and two assistants are constantly tinkering with new recipes or baking techniques, says Krsna C. Salazar, the company's chief operating officer. It can take years for that research to bring to market a new product — like vegan marshmallows, which are for sale, and gluten-free doughnuts that don't require xanthan gum, which the company is working on.

The labor and ingredient costs that go into developing such innovations — or even new flavor combinations, like green shiso doughnuts — qualify for the R.&D. credit, said Ken Pischel, an accounting consultant for the firm, which employs about 120 full- and part-time workers.

More companies will be able to take advantage of the credit, which has been broadened in application.

Previously, for instance, start-ups with no profits to speak of — and therefore no income tax liability — couldn't take advantage of this credit. But starting in 2016, some start-ups that have less than $5 million in gross receipts can apply the credit to the Social Security portion of an employer's payroll taxes, up to $250,000, said Magda Szabo, a tax partner at Grassi & Company in New York.

Another obscure-sounding provision may be even more useful: Section 179 write-offs were made permanent.

Why is this so important? Because those deductions are related to equipment, and the tax break can apply "to pretty much anything you can touch," said Barbara Weltman, author of "J.K. Lasser's Small Business Taxes 2016: Your Complete Guide to a Better Bottom Line." That is, with the exception of most real property.

Construction companies, for example, can't use this provision to write off a building. But the purchase of a cement mixer may count, Ms. Weltman said. And "if you own a small motel, all the new ironing boards you buy for each room qualify, too," she added. So do basic computers and software. "Even new desk lamps qualify."

In recent years, small-business owners could use the Section 179 provision to write off up to $500,000 toward the purchase of new or used equipment as well as off-the-shelf software.

But at the beginning of last year, that limit was set to fall to just $25,000. That is, until the PATH Act made the provision permanent and reset the limit at $500,000 for the 2015 tax year. That amount will also be adjusted for inflation.

Before small-business owners take this deduction, though, they need to be aware of another option: In November, the Internal Revenue Service issued new guidance on the ability of small businesses to simply expense tangible property.

Small businesses have long had the ability to immediately write off smaller equipment purchases of up to $500 instead of taking depreciation deductions and carrying those assets on their balance sheets.

Starting in the 2016 tax year, the agency will raise the amount small businesses can immediately deduct to $2,500 — provided those purchases can be substantiated by an invoice. This has the effect of sweeping in larger purchases, including office equipment and computer equipment.

"This just simplifies a lot of lives," Ms. Weltman said. "There are a lot of small businesses that don't care about their balance sheets. They're not likely to be applying for a commercial loan where someone looks at their balance sheet. They're more concerned about keeping things simple."

Crystal Stranger, a tax expert in Hawaii who works with many small businesses, cautioned that entrepreneurs should base their expensing decisions not just on the nature of the equipment in question, but "on the business and what is needed at that time."

She noted, for example, that a start-up company with little current income might not need to deduct purchases immediately for upfront tax relief. Instead, it might choose to stretch out depreciation, as the I.R.S. allows. "When income does eventually come in, you will be able to reduce your tax exposure at that time," Ms. Stranger said.

She also cautioned entrepreneurs to be careful when deducting expenses like the cost of a car. "The majority of entrepreneurs don't have a vehicle that's used entirely for business purposes," Ms. Stranger said.

Section 179 does allow small-business owners to write off purchases of vehicles that are used more than 50 percent for business purposes. But for most passenger cars, the first-year deduction limit is $3,160. It is $3,460 for many lightweight sport utility vehicles and pickup trucks. That's not counting an additional $8,000 in potential bonus depreciation if the vehicle qualifies.

For many business-use vehicles weighing from 6,000 to 14,000 pounds — which tend to be S.U.V.s, vans and trucks — small-business owners can deduct up to $25,000 under Section 179 rules, plus 50 percent in bonus depreciation for new vehicles.

If they go this route, though, small-business owners must maintain records and receipts of a wide range of expenses including repairs, tires, parking fees, registration fees, insurance, tolls, gas and oil.

The other option is for small-business owners to use the standard mileage deduction.

With the price of gasoline falling, though, for the 2016 tax year, the I.R.S. reduced that deduction slightly to 54 cents per mile for business use, down 3.5 cents a mile from last year.

In another tax rule category, the absence of inflation is why contribution limits to most retirement savings plans geared to small-business owners and the self-employed will be the same this year as in 2015. With Simple I.R.A.s, employees of small businesses can contribute up to $12,500 in 2016 ($15,500 for workers 50 or older) while employers can generally match up to 3 percent of participant compensation.

The self-employed or freelancers may choose to go with an individual 401(k) retirement plan. Like an employer-sponsored 401(k), these plans let a worker stash as much as $18,000 a year in 2016, while workers 50 or older can save an additional $6,000. Regardless of which plan a person chooses, it's particularly important for the self-employed and entrepreneurs to take advantage of tax breaks to save. With highly variable income and no large employer to prompt them to save, "the self-employed need to make their own retirement planning a priority as early as possible," said Maria Bruno, a senior investment analyst at the Vanguard Group.

Another change that's noteworthy for the 2016 tax year: rising penalties under the Affordable Care Act.

Self-employed people or entrepreneurs who do not have coverage for "essential health benefits" for three consecutive months or longer this year — and who don't qualify for an exemption — will be subject to a stiff fine. In 2016, the penalty rises to 2.5 percent of annual household income (up from 2 percent in 2015), or $695 per adult and $347.50 per child, up to a maximum of $2,085 per family — up substantially from $975 for a family in the 2015 tax year.

Ms. Stranger warned, "This is now a big risk for entrepreneurs who don't carry health insurance."

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