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Tax Extenders: The Slow Boat

BY DEAN ZERBE, former Senior Counsel to the Senate Finance Committee and alliantgroup National Managing Director

Over the last year, the House and Senate have both proposed bills to renew a number of popular tax breaks for businesses and individuals. These “extenders” include some important changes of which tax preparers and accountants – especially those dealing with the nation’s small and mid-sized businesses – need to be aware. Among the most beneficial of these tax extenders for businesses included in the Senate Finance Committee markup are the **Research and Development Tax Credit**, as well as Section 179d (expensing for small businesses) and bonus depreciation.

An extender that isn’t as well known – but has a big bang for some architects, engineers and design-construction companies – is a tax benefit for energy-efficient buildings, **Section 179D** (179 cap “D” – not to be confused with 179 little “d” – expensing. I have no idea why when we created 179D as part of the energy bill we didn’t just give it a separate number).

Two Important Proposed Changes

R&D Tax Credit: The R&D Tax Credit has been a regular fixture of the tax code for over three decades, has been extended 15 times since it was first passed in 1981 and is generally much more expansive – not to mention generous – than your average business realizes. Some business underutilization is due to a failure to understand what the credit covers (more on that below) but also that the law has, at times, not been particularly friendly to small and mid-sized companies – but change is in the air.

The first change in the R&D Tax Credit has already happened – the Treasury Department changed its regulations in June of this year and allowed companies to take the **Alternative Simplified R&D Tax Credit, ASC, on amended returns**. Previously, Treasury regulations had only allowed businesses to take the ASC on original returns.

The additional modifications to the R&D Tax Credit proposed by Congress are similar game-changers. For one, the Senate accepted an amendment that allows the R&D Tax Credit to be taken against the Alternative Minimum Tax.

Another big change is an amendment that would allow start-up companies in their first five years to take the R&D Tax Credit against business/payroll taxes (capped at \$250,000 per year). This proposal fills a policy void of the R&D Tax Credit – namely, that the credit currently is not available for start-ups, some of our most innovative firms and biggest job creators. If they become law, both this change and the AMT fix would be good starting Jan. 1, 2014. Note: All the Senate-passed extenders would be for two years.

Finally, the House passed an R&D Tax Credit bill that expands R&D considerably (taking the ASC from 14% to 20%) and makes the R&D Tax Credit permanent – goodbye extenders!

With all this good news regarding the R&D Tax Credit, especially for small and mid-sized businesses, accountants need to remind themselves and their clients of what qualifies for R&D. The answer is probably easier than you think. While laboratory research is certainly a candidate, the credit rewards businesses that are improving upon an existing product or process, opening the door for companies in industries as diverse as manufacturing, software and technology, architecture, engineering, contracting, construction, agriculture and much more to qualify for the credit. ***The bottom line: If a company is in the business of making a product or service quicker, cheaper, greener or simply more efficient, chances are they are a prime candidate for R&D credits.***

Energy Efficient Buildings

Originally passed as part of the Energy Policy Act of 2005 (and extended by Congress in both 2006 and 2008), 179D provides a benefit for businesses when they design or renovate a building that is energy-efficient. Any business performing eligible services can receive a tax deduction of up to \$1.80 per square foot, providing potentially valuable tax savings depending on the size and scope of a project.

As a general rule of thumb, I would divide the people that can qualify for 179D into two separate groups:

1. The first group, commercial building owners, can qualify for energy-efficient improvements made to their building within the last six years and can take the deduction in the current year on the basis of the improvements.
2. The second group, designers – and by designers, I mean the **architects, engineers, contractors and energy service providers that actually do the work to make the building energy-efficient** – can benefit for qualifying improvements made to government-owned buildings at the federal, state and local levels. As government entities do not pay tax, 179D allows the government to “allocate” the tax deduction to the designer performing eligible work on the building. Qualifying designers can go back three years with their projects to claim the deduction.

As far as eligibility goes, all sorts of buildings – basically any structure built for any level of government – can potentially qualify for 179D. The deduction covers energy-efficient improvements made to the interior lighting,

HVAC systems, hot water systems or the building's envelope. As long as the improvements surpass 2001 ASHRAE standards - standards that most state codes already surpass - then a business can qualify for 179D. For energy-efficient enhancements made to a number of public school buildings, one mechanical contractor received \$706,964 in federal tax deductions - a nice return for typical, everyday contracting work.

The change that the Senate proposed on energy-efficient buildings is to allow charities and Indian tribes to also allocate the tax benefits to the designer. The provision also updates the energy-efficient ASHRAE standards and would be good starting Jan. 1, 2014. Given the need to get allocation letters from the government (with the possible expansion to charities and Indian tribes) accountants should talk to their design clients now about the possibilities so they are prepared if the changes to the law come into place.

The Road Ahead

The general outlook on extenders is that nothing will happen before the elections. The smart money is that extenders will be addressed in the lame duck session (most likely as part of a bigger package) and that the deal being talked about in D.C. is that the House will basically accept all the Senate provisions/extendere - including 179d and bonus depreciation. I would expect the changes to R&D on the AMT will be accepted by the House (and possibly on start-ups as well - but with a harder road ahead). The changes to energy-efficient buildings for charities and Indian tribes coupled with the raising of ASHRAE standards should be acceptable to the House. I would anticipate that the Senate would accept an increase of ASC.

However, the House will likely insist that a few extenders be made permanent (the candidates being the R&D Tax Credit, 179d and a charity provision or two - the charitable IRA rollover would seem to be the logical one). Expect there to be some teeth gnashing as to making some extenders permanent - but the Senate Democrat leadership will also have a few items (such as refundable credits) that they want to have made permanent ("everyone's a winner"). In short, a deal on extenders is quite doable and could be wrapped up before Christmas. Well, maybe.



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