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<u>Qualified Leasehold Improvements ("QLHIs") are Eligible For Serious Tax Benefits, But Are Not Available To Everyone</u>: The big tax law change from the "Protecting Americans from Tax Hikes Act of 2015" revived three wonderful tax breaks for leasehold improvements:

(1) Shortened 15 year depreciation (down from 39 years)
(2) Section 179 immediate expensing up to $500,000, and
(3) Bonus depreciation

The first two are now permanent. The third, bonus depreciation, will last until 2019. The best years are 2016 and 2017 when bonus depreciation is 50% of the remaining un-depreciated cost. It drops to 40% in 2018 and 30% in 2019 and is gone in 2020.

To see how big the benefits can be, consider the following example: If $800,000 of needed improvements are made in 2016 or 2017, then your first year deductions are $660,000:

$<u>500,000</u> of Section 179, plus
$<u>150,000</u> as 50% bonus depreciation on the remainder, plus
$ <u>10,000</u> based on the 15-year depreciation period.

In a 39.6% federal tax bracket, that saves $261,360 in first year taxes. Considering the time value of money of having this cash to invest now, rather than claiming the tax savings slowly over 39 years, this is a great deal!

<u>The Requirements to Qualify</u>: These are wonderful benefits, but they are not available to everyone. Section 168(k)(3) of the tax law defines a QLHI as any improvement to an interior part of a building that is <u>non-residential real property</u>, the property is subject to a <u>qualified lease</u>, the improvement is made by the lessor, lessee or sublessee, and is made <u>more than three years after the building was first placed in service</u>.

<u>The following do NOT count as improvements</u>: enlarging the building, elevators and escalators, any structural component benefitting a common area and internal structural framework (e.g., load bearing walls, columns and beams).

Most everything else will, such as walls, doors, windows,

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pipes and fittings, HVAC, permanent interior finishes and floor coverings, etc.

Many doctors will fail to meet these tests because they don't have a qualified lease: The qualified lease rules fall under Section 168(k)(3) and Section 267(b). If the lease is between "related parties" it is not a qualified lease. The prohibited related party relationships include:

(1) members of a family (i.e., husband (H) owns practice and wife (W) owns building);

(2) an individual and a family member's corporation (H owns practice corporation and W owns building individually or in an LLC);

(3) two C corporations that are members of a controlled group (H owns C corp practice and W owns building in C corp. This structure is unrealistic. Real estate should not be owned in a C corp because the appreciation will be subject to double taxation);

(4) two S corporations (H owns practice in an S corp and W owns building in an S corp);

(5) a corporation and a partnership or multi-owner LLC (H owns the incorporated practice and H and W jointly own building in an LLC); and

(6) an S corp and a C corp (practice is a C corp and building owned in an S corp).

The following are examples of qualified leases:

(1) a lease with a third party landlord;

(2) a partnership (or multi-owner LLC) and an individual (or single member LLC) (i.e., H owns practice as a Schedule C taxpayer or in an LLC and H and W own building in an LLC); and

(3) a partnership (or multi-owner LLC) and another partnership (or multi-owner LLC).

267(b) disallows most related party relationships, but it is oddly silent on the partnership-individual relationship and the partnership-partnership relationship (numbers 2 and 3 just above). It does not incorporate the related party rules for partnerships contained in Section 707(b). This seems to present an opportunity for family members to avoid the related party rules and disqualification of QLHI tax benefits. For example, if the doctor is a Schedule C taxpayer or a single member LLC, then the building can be put into a family partnership or family LLC.

This is the gray area of the tax law. Our philosophy for dealing with the gray area is to be aggressive and interpret ambiguities in our favor. If this situation might apply to us, we would claim the QLHI deductions. The worst that we conceive happening is that the benefits are disallowed, and we go back to the slow 39-year depreciation rules.

Even if You Don't Qualify for the Three Great QLHI Tax Breaks, You May Still be Eligible for One of Them - Bonus Depreciation: The majority of our doctor clients own their office building or an interest in the building. Because these are related party situations, building improvements will likely not be eligible for the three big tax breaks described above. **But, even though they are not "qualified leasehold improvements" they are still considered to be "qualified improvements." Under the tax laws, the short 15-year depreciation and the great first-year $500,000 expensing aren't available, but bonus depreciation still is!**

So, in the $800,000 example above, $400,000 is depreciable in the first year and the remaining $400,000 is written off over the long 39-year period. This is far better than deducting the entire $800,000 investment slowly over 39 years.

Remember, bonus 2016 and 2017 are the best tax years to make the improvements, as the 50% deduction falls in 2018 and 2019 and is gone in 2020.

ABLE Accounts are Starting to Take Off: These are tax-favored accounts for disabled individuals. FL, NE, OH and TN are the earliest adopters, in an effort to generate interest nationally, but like 529 plans will become

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available everywhere. The plans work like 529 plans with after-tax contributions up to $14,000/yr being made on behalf of someone who became blind or disabled prior to age 26. The account grows tax-free, and distributions will be tax-free if the money is used for their support broadly defined (e.g., housing, job training, education, transportation, etc.). The size of the account won't affect the individual's eligibility for Medicaid, and if the account is $100,000 or less, it won't reduce Social Security Income (SSI) benefits.

According to Bill Rossi of Advanced Practice Management, There Seems to be a Law of Diminishing Returns by Adding the Next PPO Plan: Practices with little or no insurance participation generally see fewer new patients than practices with more participation. However, is there a point where there are diminishing returns with increased PPO participation? Anecdotally, he (and we) have noticed that practices that participate in almost every PPO available don't see a proportionally greater number of new patients, and sometimes even see a drop. So, he looked into his company's considerable database to measure this statistically.

To summarize the results: Practices that have no or very little PPO participation tend to have significantly less new patients. On the other hand, practices with deep PPO participation **do not see proportional increases in new patients to account for the added write-offs**. The data shows the best position is to have a modest amount of PPO participation. For most practices this would mean a collection percentage of 80% to 90%. The moral is don't be quick to sign up for the umpteenth PPO. It won't be worthwhile.

Editor's Note:* *We are delighted that Bill Rossi will be speaking at our three-day Business, Tax and Practice Management Seminar in Scottsdale, AZ, Dec. 28-30, on the subject of managing and negotiating PPO participation. To register for the seminar, go to www.CollierAdvisors.com/seminars or call our office at (216) 765-1199.

"Personal" Expenses In Group Practices: We still see group practices where the doctors have a difficult time with their end-of-the-year accounting for practice paid quasi-personal expenses. These might include auto expense, retirement plan contributions, seminars at resort locations, entertainment, etc. These doctors either exchange money on the side or do not allow themselves to run these expenses through the practice -- a frightful waste of deductions.

Here is a simple solution. Whatever system is used for allocating profits between doctors, just include all of the quasi-personal expenses as part of the "profits" being allocated.

Let's say two partners split everything equally, but they have unequal personal expenses. Assume there is $400,000 of profitability to be divided for the year after subtracting $80,000 of practice paid personal expenses -- $60,000 for Dr. A and $20,000 for Dr. B. They should consider $480,000 the true "profitability" to be divided for the year with each doctor being entitled to one-half, or a total of $240,000 of compensation and quasi-personal expenses. Since A's practice paid personal expenses ($60,000) were higher than B's ($20,000), A's take-home pay ($180,000) would be lower than B's ($220,000).

This simple technique means that neither doctor has to be as concerned about the level of quasi-personal expenses that the other partner runs through the practice.

The Pitfalls of Retirement Plan Loans: The IRS is fanatical in its treatment of retirement plan loans made to participants. No slack will be cut, and the IRS will look for any possible mistake in order to treat the loan as a taxable distribution. In a recent Tax Court case (Martinez, TC Memo, 2016-182), the taxpayer stopped repaying her loan after two years. Her employer properly sent her a 1099 reporting the remaining loan balance as taxable income. She did not report the income on her tax return. The IRS audited, assessed the income tax, **plus** a 10% penalty due to the premature distribution before age 59-1/2 **and** a 20% penalty for good measure.

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If we need money, we will borrow it from a bank. The only time we might not is in the very unlikely event that we needed cash in a hurry and the loan application process would take too long. The details of retirement plan loans are strict and should only be done with the help of your plan provider.

Do Any Year-End Tax-Loss Stock Selling Early: We do not recommend letting tax considerations dictate investment decisions, but we cannot ignore them either. This and the next item review two year-end strategies you might consider. This year has been unusual for stock prices -- sharp drops during the first couple of months and sharp rises after that.

If you intend to sell losing stocks to shelter gains from other sales, do your planning now. Waiting means you could find prices of this year's losing stocks artificially depressed by tremendous selling pressure during the traditional December tax-loss selling season.

What If You Want The Tax Loss From A Losing Stock But Don't Really Want To Part With The Investment? You can do this, but the tax "wash sale" rule requires you to bear some risk. A loss is not deductible if you purchase shares within 30 days before or after the sale. In other words, you could not sell and buy back the shares the next day. Let's say you bought 1,000 shares of Twitter at $50 and it's now selling at $20. You want the $30,000 capital loss this year but don't want to give up on the stock. Here are the two common ways to meet the wash sale rule, but each carries a price risk:

1. Buy another 1,000 shares at $20, wait 31 days and then sell your first (high cost) shares. The risk is that if the price drops further, you are exposed on all 2,000 shares for the 31-day period.

2. Sell the 1,000 shares, wait 31 days and then buy them back. Your risk is that the price could rise before you buy back the shares.

Who Owns Patient Records? The fine points can vary from state to state, but generally your records belong to you, and your patients have a right of access to the information. A patient can request that his or her records be sent to another doctor, but it is generally unwise to give up the originals.

An unpaid bill is not an excuse for refusing or delaying to deliver the records. If there is an outstanding bill, you could consider asking the patient to come in to pick up their copies. That gives your office manager another chance at collecting. Be careful with that strategy because you do not want to be accused of demanding a condition that delays delivery. If the patient refuses to come in or misses the appointment, send the records and collect by other means.

Notify Social Security Administration of Any Name Change: We don't know if this is a bizarre aberration or a common problem. The doctor's working daughter married, changed her name (let's say from Mary Jones to Mary Smith) and took no further action. Several years later, the IRS audited her and her husband's joint tax returns. The agent treated her like a crook. He suspected fraud because someone named Smith was filing tax returns using Mary Jones' social security number. A marriage certificate satisfied the agent on that issue, but he still audited the rest of their returns.

We know of no penalty if the Social Security Administration is not notified, but it is easy to do, a new card is issued and a possible later problem is avoided.

Safe Deposit Box in Corporate Name: If the name on the safe deposit box is the corporate name, the box is not sealed at the death of the doctor. The "signers" to the corporate box could be the doctor and spouse. The spouse may need to be an officer of the corporation to have access, which can easily be done in the annual shareholder and director minutes.

Snow Removal Equipment: A dentist in Indiana has his practice own the snow blower and deducts all expenses. He treats the use of the snow blower at home as "incidental." Sounds like a good idea to keep in mind as the weather turns chillier.

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