MHCS

THE TAX ROUTE

financial information for the long haul

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About MHCS

At MHCS, we are dedicated CPAs and Business Advisors that love nothing more than to see you succeed. We work with you to gain a deeper understanding of your current landscape and discover your short and long-term goals. We are thrilled to be your trusted advisor, offering a complete range of services including audit and assurance, tax and accounting, business advisory services, client accounting services, consulting, and financial planning to meet your unique, diversified, and sophisticated needs. We have a passionate commitment to responsive, personal service, and this is reflected in everything that we do for you.

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Our Transportation Team

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Dan joined the firm in October 1990. In addition to his daily client and firm responsibilities, Dan leads the firm's transportation market and specializes in business valuation, consulting and tax services. He is originally from Maynard, IA, and attended Hawkeye Institute of Technology, where he received his associate of applied science degree. Dan holds board of director positions with the Iowa Motor Truck Association Allied Division and the Blank Park Zoo and is a member of the American Institute of Certified Public Accounts and the Iowa Society of Certified Public Accountants. DSchwarz@MHCScpa.com

JENNY SMITH, CPA, CFE | ASSURANCE DIRECTOR
Jenny joined MHCS in November 2009. Jenny specializes in closely-held businesses such as manufacturers, distributors, construction, and transportation. She also works with employee benefit plans and performs fraud services. Jenny is originally from Oskaloosa, Iowa and received her bachelor degree from Iowa State University. Jenny is a board member at Hawthorn Hill and Bidwell Riverside Center and is a member of Iowa Society of CPAs, American Institute of CPAs, and the Association of Certified Fraud Examiners. She is also a member of Lead like a Lady, is a 2016 graduate of the West Des Moines Leadership Academy, and a 2016 Business Record Forty Under 40 honoree. JLSmith@MHCScpa.com

LIZ KRAUSE, CPA | SUPERVISOR
Liz joined the firm in June 2016. Liz specializes in tax for closely held businesses, as well as state and local tax issues. She is originally from Carroll, Iowa, and attended Creighton University, where she received bachelor degrees in accounting and financial planning. Liz is a member of the American Institute of CPAs, the Iowa Society of CPAs, and CPAmerica International. She is involved with the Johnston Chamber of Commerce and firm-wide community and service events. LKrause@MHCScpa.com

Best Strategies for Replacing Equipment by Dan Schwarz

In our practice, we have the privilege of working with several types of transportation companies. While each company has their own unique need for our tax and consulting expertise, there are some requests that arise regardless of the type of transportation involved. One of the most common questions we receive is when and how to best replace tractors and trailers. Several factors must be analyzed when making this decision including driver retention and recruiting, maintenance, fuel costs, age of fleet, tax implications, financing availability, and new and used equipment pricing. As accountants, we strive to help our clients understand the accounting, tax, and financing aspects when strategizing equipment trades.

When it comes to depreciation, there is a unique challenge facing companies today. There have never been greater differences in the way equipment is depreciated for accounting purposes (GAAP) versus tax purposes. While a company may make decisions based on the reduction of taxes, their lender may make lending decisions based on the company's level of debt and cash flow. For the best result, it is key to balance the company's and the lender's requirements.

The Tax Cuts and Jobs Act of 2017 (TCJA) greatly enhanced a company's ability to accelerate tax depreciation of newly purchased equipment. Between now and the end of 2022, companies can immediately expense new and used equipment purchases. While this certainly created a great tax incentive to purchase equipment it was offset with the elimination of like-kind exchanges for equipment and other personal property. A company can no longer defer tax gains on equipment traded for newly purchased equipment. While companies now must recognize gain on traded equipment, they no longer need to worry about going through the proper steps to qualify for a like-kind exchange and they are able to seek out the highest value for used equipment.

For accounting or "book" purposes, newly purchased equipment is depreciated based on its useful economic life. For example, a tractor may have a five-year life. If the tractor costs $150,000, for accounting purposes the company would depreciate the equipment $30,000 a year for five years. However, for federal tax purposes the entire $150,000 can be expensed in the year of purchase. This creates large differences between accounting net income and taxable income. When planning, it is important to project both accounting and tax depreciation to avoid being caught off guard by these differences.

To make it even more complicated, several states (including Iowa) have not adopted the TCJA deprecation rules. Therefore, state taxable income can be substantially different from federal taxable income. Many transportation companies file in multiple states, so it is important to be aware of the difference depreciation rules each state may have when filing state income tax returns.

As mentioned, banks and equipment lenders tend to look at a company's cash flow when making loan decisions as cash flow is a major indicator of a company's ability to repay its debt. Cash flow can be measured by different criteria and is usually dictated by the lender. For example, a lender may rely on the "debt service coverage" (DSC) ratio, which is net income plus depreciation and interest expense divided by the company's debt. The DSC ratio calculates the amount of "cash" a company may have available after tax to service annual debt (principal and interest expense) and lenders will set ranges on where they would like this ratio to be. It is important for companies to be aware of how this ratio changes when they purchase equipment. If the ratio gets below 1.0, this indicates the company may not be able to pay current and long-term debt obligations and may be a red-flag to lenders.

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During the late 2000's and early 2010's, many asset-based transportation companies significantly slowed down the turnover of their fleets. There were many reasons for this slow down including the hangover of the Great Recession, new engine requirements, high fuel costs, and low freight prices. As the trucking economy began to improve, many companies realized much of their fleet was old and completely depreciated. With the ability to fully depreciate equipment for tax purposes and lower taxable income, many companies began replacing their equipment at an accelerated rate. Unfortunately, some companies did not take into consideration the long-term impact of this strategy. These companies are now facing a situation where their taxable income is high due to the lack of depreciation expense. Ideally, they would like to make additional equipment purchases to increase depreciation expense, however they are unable to obtain financing at favorable terms since their DSC ratio is less than desired for lenders. This situation emphasizes the need to strategize equipment purchases from both a tax and lender perspective.

The accounting, tax, and financing aspects alone can be overwhelming when determining the best time to purchase tractors and trailers. We stress the importance to our clients in working with us to develop a financially sound approach for not only current year but also future year purchases. A good equipment purchasing strategy can lower tax liabilities and provide for optimal financing options, which in combination can help a company's overall bottom line and overall growth strategy.

Iowa Tax Changes by Liz Krause

With every new tax year, modifications to the law are evident. Iowa has numerous changes for the 2019 tax year that we want our clients to be aware of. The Tax Cuts and Jobs Act (TCJA) differed from many states in 2018. However, the consensus is that Iowa will be moving toward more conformed laws with the federal tax code. Specific changes that may impact a taxpayer's tax return are addressed below.

The Section 179 amount of deduction has been increased to $100,000 for up to $400,000 of fixed assets purchased. This will allow taxpayers to deduct the cost of tangible assets placed in service in the current year instead of over several years. The flexibility that is granted with Section 179 can allow a taxpayer to alter their taxable income to a desired amount.

New to the Iowa return this year is the Qualified Business Income Deduction. This was a new deduction in 2018 for the federal return that was implemented with The Tax Cuts and Jobs Act. It allowed taxpayers to deduct up to 20 percent of their qualified business income. The Iowa deduction will now allow taxpayers to take a 25 percent deduction of the 20 percent federal deduction. For example, if there is a qualified business income deduction of $5,000 on your federal tax return, you would then have a 25 percent deduction on your Iowa return of $1,250.

Other small changes that may apply to some taxpayers includes the removal of miscellaneous itemized deductions on an individual's tax return. This includes tax preparation fees, investment fees, and unreimbursed business expenses. The standard deduction has increased in 2019 to $2,080 for single filers and $5,120 for joint filers.

As always, please reach out to us on any questions that may arise, and we will be happy to assist you.

Tax Planning Strategies for 2019

We often get asked how we can save our clients' money, and as most answers to tax-related questions go, it depends. Each situation is different and not every solution will apply to all taxpayers. In this article, we will briefly explain a few different ways you could reduce your tax liability in 2019.

- Consider donating appreciated securities to a donor-advised funds. These appreciated securities will entitle you to a charitable contribution at the fair market value, not your original cost basis. With the increased standard deduction and state and local tax cap, this is a great way to itemize your deductions and receive a direct tax benefit for your charitable contributions. Another advantage of this is that it could position you to claim the new 20% pass-through deduction due to lower taxable income if you are a business owner that may have been previously limited on the 20% deduction.

- An alternative idea to save money on appreciated securities or property is to sell them and invest the capital gains in an Opportunity Zone ("OZ"). For example, let's say you have a $100,000 capital gain from the sale of securities. You decide to invest the $100,000 into an OZ investment within 180 days of the stock sale. This entitles you to defer the stock gain until the earlier of December 31, 2026 or the date the OZ investment is sold. There is also the potential to permanently exclude 10%, 15%, or 100% of the appreciation on the OZ investment if it's held for a certain time-period.

- There are a couple of Iowa specific ways to save money as well.
  - One of the methods is the 529 plan. A notable change to the 529 plans is that $10,000 can be withdrawn for private elementary and high school tuition annually.
  - Another method is the first-time homebuyer savings account ("FTHSA"). Most people are familiar with 529 plans, but may not have seen the FTHSA. This is a special bank account that is used to purchase a taxpayer's "first" home. The FTHSA is similar to the 529 plan in that people can make tax-deductible contributions for anyone, including themselves. The deduction is $2,050 for 2019 ($4,100 for married couples) and can be made up to 10 years in a row. If there is money in the account 10 years after it was opened, the account is no longer considered a FTHSA subjecting it to income recapture. So, if you have children or grandchildren that you know will be purchasing a home in Iowa within the next 10 years, consider talking to your banker about setting up an account.

If you have any questions or thoughts about reducing your tax liability, feel free to let us know as we would be happy to review your situation and discuss different planning options that best fit your goals.

Lease Accounting Standard Update by Jenny Smith

In November 2019, the Financial Accounting Standards Board delayed the implementation of several Accounting Standards Updates. ASU 2016-02, Leases, will now be effective for private companies for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. This changes the effective date from calendar year 2020 to calendar year 2021. The standard will require a lessee to recognize a right-of-use asset and a lease liability on its balance sheet for most leases, including operating leases. Most companies will see a significant impact on the balance sheet when the new standard goes into effect and, therefore, should continue to plan for the changes now. Let MHCS be a resource for you to understand the changes ASU 2016-02 could have for your company.

State Tax Alerts

Tennessee
The Tennessee Department of Revenue decided to disengage from the Business Interest Expense Deduction (IRC sec. 163(j)) set in place by the Tax Cuts and Jobs Act. In tax years beginning on or after January 1st, 2020, the Business Interest Deduction will not be limited for state purposes. Tennessee will continue to recognize the federal limitation for tax years 2018 and 2019.

Kansas
On October 1st, 2019, Kansas Department of Revenue announced that it may waive the late filing penalty on the 2018 Kansas corporate income tax return if the return was filed within a month of the federal extended due date. To waive this penalty, th taxpayer must indicate on its return that it is seekin "an October 15 to November 15th penalty relief extension."

California
The California Office of Tax Appeals recently rejected the California Franchise Tax Board's attempt to narrow the scope of an out-of-state corporation "doing business" in the state. In the appeals case, a 0.2 percent membership interest limit was set forth in a court decision in 2017, but the Office of Tax Appeals says the decision was grounded more on the relationships between the out-of-state member and the in-state company. The decision was not based on the membership interest amount.

Louisiana
Louisiana's governor signed a new law for an election that allows certain passthrough entities to pay Louisiana corporate income tax at the entity level beginning with the 2019 tax year. The election is made at the entity level. If not elected, partners or shareholders will continue reporting income on their respective state income tax returns.

Illinois
The Illinois Tax Amnesty Program that started on October 1st, 2019 will continue to run up until November 15th, 2019. This amnesty programs applies to most taxes beginning June 30, 2011 to July 1, 2018. Participation in the program will provide qualifying taxpayers a potential waiver for all underlying penalties and interest. The department is in the process of mailing amnesty-related notices to all eligible taxpayers.

Illinois
The Illinois Income Tax Act has been amended to address wages and withholdings for individuals performing services in Illinois. Compensation is to be paid in Illinois for tax years ending on or after December 31, 2020 if three conditions are met. First, a portion of the individual's services must be performed in Illinois. Second, the services performed within the state must be non-incidental to the services performed outside the state. Third, the individual performed services within Illinois for more than 30 working days. A working day is defined as spending the majority of a day in Illinois performing services. The withholding requirement states that income tax must be withheld from nonresident employees meeting these requirements. The withholding is calculated using a ratio of days worked inside the state of Illinois to total days worked.

We Want to Hear From You

- How can we help you?
- What do you want to learn about?
- What trends are you noticing in your business?
- Anything else you want to share with us?

Your feedback will help us make sure we are providing you with information and support that you and your company need. Please feel free to reach out to us with any comments or questions you have. We are always happy to help!

MHCS Service Department Updates

Tax Department

Our tax department is working with clients on their year-end planning to help minimize their tax burden for 2019 as the federal and state tax rules are continuously changing. The fourth quarter is an essential time to review the year, discuss current situation, and implement changes to help increase cash flow and maximize tax savings.

Assurance Department

Our assurance department is beginning year-end planning for December 31st clients. Planning involves discussing projected year-end results with our clients along with any challenges the year has brought. We also discuss accounting changes with our clients during planning. While we have discussed the changes in revenue recognition with our clients last year, we will continue to visit with them on this topic before December 31st as the changes in the revenue recognition guidance is effective for December 31, 2019 year-end entities.

Client Accounting Services (CAS) Department

We have many different types of solutions for our Client Accounting Services clients. An application that we and many of our clients are having success with is Gusto Payroll. We recommend this software to clients who would like to prepare their own payroll, but would like the taxes and reports to be completed automatically. From our experience, we recommend this type of payroll solution for most clients who have QuickBooks Online (QBO). Gusto Payroll syncs well with QBO providing a good connection and platform to work from with their support option an added benefit.

Business Advisory Services (BAS) Department

The BAS team continues to assist clients in need of non-compliance services. For example, over the past few weeks we have helped a client refinance their existing debt with a new lender, reviewed the bank's proposal, and provided feedback. We have also been helping a client in the due diligence process for a potential business acquisition, including meeting with the client, reviewing the prospects financial information with them, and answering their questions to discover if this opportunity will be a good match.

In Transportation Territory This Quarter

- November | Dan Schwarz attended the IMTA Annual Board Meeting.
- December | Dan Schwarz and Jenny Smith attended the annual holiday party at the IMTA headquarters.

MHCS News

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