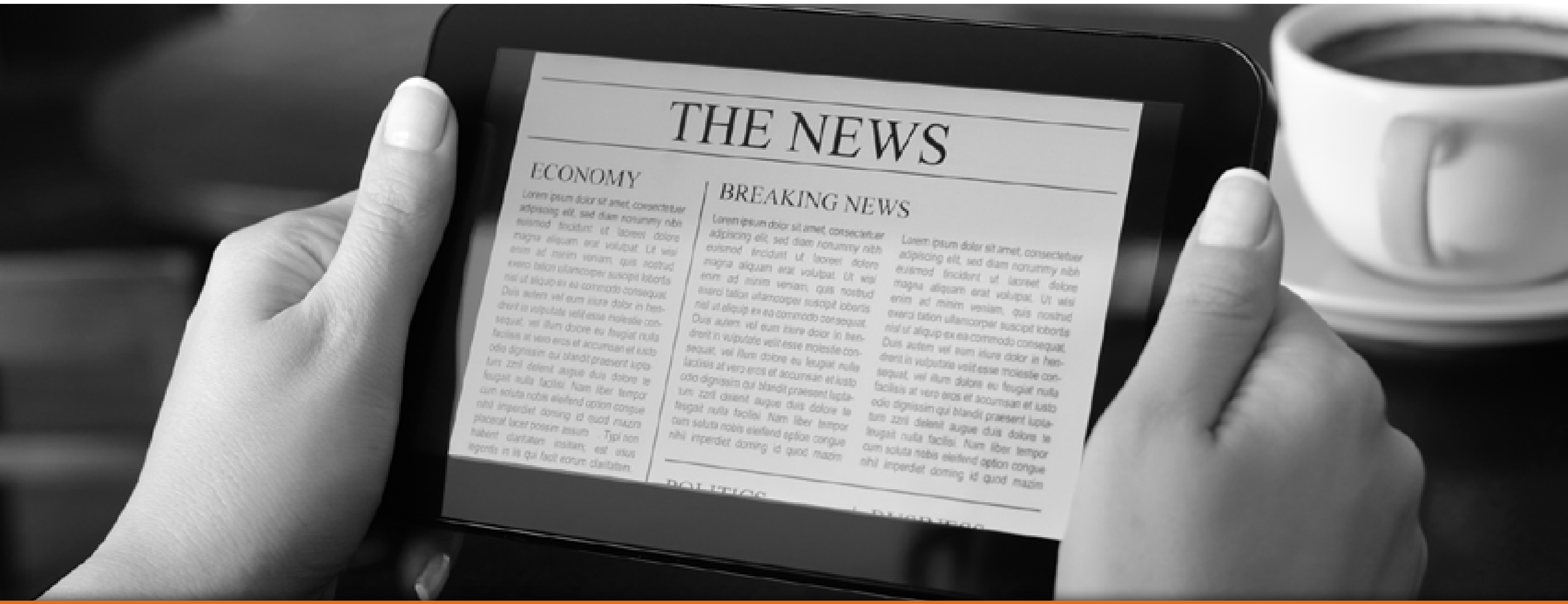
HOWARD



HOWARD ANNUAL UPDATE

2016

Dear Clients and Friends:

As we reflect on 2016, and consider our expectations during this time last year, we noted that we expected a relatively volatile year based upon historical election cycles. This appears to be exactly what we experienced. Looking forward, in the first year of a president's term, the market has averaged only a 2.5% return. However, if this election cycle taught us anything, it illustrated that historical trends and predictions are not necessarily reliable. Certainly there is some anxiety as to what tax and other regulatory changes will look like once the administration-elect takes office in January. Before we get to that point, we need to consider changes that have occurred in the past 12 months, and their impact on your 2016 tax filings, as well as your organization's financial results.

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2016 Overview:

- 2016 has been an uneventful year for tax reform. There were typical increases related to inflationary changes, adjustments to the tax brackets, and increased penalties for the non-insured individual taxpayers under the Affordable Care Act.
- The Internal Revenue Service issued a notice regarding increased identity theft related to tax filings. The IRS reversed a previous position and will now provide filers with copies of requested fraudulently filed tax returns.
- During 2016, two very significant accounting pronouncements took strides toward implementation dates. One of the pronouncements, related to revenue recognition, was in development for more than a decade. The new revenues standard will redefine how many organizations recognize revenues. The second new pronouncement relates to accounting for leases which will have significant impact on the amount of assets and liabilities reported by most organizations.

We value our position as your trusted advisor and we look forward to the conversations we will have as a result of the information shared in our annual update. As business owners ourselves, we understand the importance of planning for future changes in your organizations and for each of us as individuals. We enjoy assisting our clients and friends identifying opportunities that result from annual changes.

Year-End TAX PLANNING

Similar to prior years, little has changed on the tax front for 2016. The PATH Act was enacted late in December 2015, which made permanent many deductions we are all familiar with, including the sales tax deduction, and ability to make tax-free charitable contributions out of IRAs for qualifying taxpayers.

It isn't likely that any additional tax bills will pass Congress in 2016. However, with the recent elections, substantial changes are potentially on the horizon. While there are proposals, no bills have been filed, and it is too early to determine what may pass Congress and be signed into law. Once things become clearer, we will send out an update covering any changes and how they will affect taxpayers.

One important change currently in effect for 2017 is the adjustment of some tax return due dates. While individuals' 1040 due dates will remain the same, due dates for entities have been altered to improve the flow of information. These changes include:

- 1120 - C Corporation returns
  - Now due April 15 (previously March 15)
  - Extended to September 15 (until 2027, when it will change to October 15)
- 1120S - S Corporation returns
  - Due date remains March 15 (no change)
- 1065 - Partnership returns
  - Now due March 15 (previously April 15)
- 1041 - Fiduciary returns
  - Due date remains April 15 (no change)
  - Extended to September 30 (previously October 15)

The due dates for businesses to file 1099s, W-2s and W-3s have been moved up to January 31st. There has also been a substantial increase in the penalty for failure to file correct information returns with the IRS.

Under current law, there are several provisions that are set to expire in 2016. Based on past actions, it is likely these will be extended. These provisions include:

- Exclusion of income on discharge of indebtedness on a principal residence
- The 7.5% of AGI floor on medical expenses for taxpayers 65 or older
- The above-the-line deduction for qualified tuition and expenses
- Several clean energy credits

The income tax brackets and standard deduction will change only slightly from 2016 to 2017. The 3.8% Net Investment Income Tax (NIIT) is still in place, and will require careful planning around investment income.

This brings to mind the usual planning strategies of deferring income and accelerating deductions. As mentioned in previous years, timing your deductions and minimizing net investment income by harvesting capital losses may help reduce the NIIT. Active versus passive participation in partnership investments is also a key component of the NIIT, and some trusts may benefit by passing out income to beneficiaries, which could significantly lower the tax inside the trust.

One final word of caution. Although the IRS is strengthening their defenses, identity theft and scams continue to proliferate. In addition to the phone calls purporting to be the IRS demanding immediate payment, taxpayers should be aware that scammers are now sending out fake IRS notices via email and the post office requesting payment. If in doubt, please consult your Howard tax advisor to determine whether a notice is in fact valid.

ACCOUNTING AND REPORTING UPDATE

2016 was an unprecedented year for modifications and clarifications in accounting and reporting for all organizations, and our audit team has spent significant time learning and analyzing these accounting changes. Below are some of the most significant changes:

Revenue Recognition

Revenue recognition rules are currently located in various authoritative sources. A new revenue recognition standard was recently issued, and will soon be effective. The new standard affects all entity types, public, private and nonprofit, and brings the U.S. accounting requirements in line with international standards. The new standard requires new and deepened financial disclosures, including disaggregated revenue details, performance obligations, and recognition of costs to obtain or fulfill a customer contract. The standard redefines how we think about contracts including even in point of sale transactions where the contract is implied and short-lived. There are 5 steps to follow in the revenue recognition process:

1. Identify the Customer Contract
2. Identify the separate performance obligations
3. Determine the transaction price(s)
4. Allocate the transaction price to the separate performance obligations under the contract
5. Recognize revenue when or as the entity satisfies a performance obligation

There are significant considerations regarding various performance obligations, including: future discounts, warranties, and licensing. Additionally, changes in revenue recognition will have implications on tax planning and filings. This standard is far-reaching; a customized implementation plan will be needed for all entities. These changes are currently scheduled to be in effect for most entities year-ends beginning after December 15, 2017. This may appear to be far off; however, as comparative financial information and disclosures are required, entities should begin the planning process to ensure the necessary information is available.

Leases

In early 2016, the requirements related to accounting for long-term leases changed significantly. Imagine that, instead of leasing retail and office space, your organization now has a long-term asset. The new standard simulates just that: it places long-term leases (terms greater than 12 months) onto the balance sheet by recording an asset and offsetting lease obligation for an amount equal to the future payments required under the agreement adjusted for its present value. Instead of recognizing lease expense for long-term leases, entities will now record a combination of interest and depreciation expense in its operating statement.

As expected, the new lease standard also increases the amount of disclosures surrounding lease agreements. There will be a significant number of entities for which this new standard will have a material effect on the amount of recognized assets and liabilities for financial reporting. There are certainly some complicating factors that require further analysis based upon circumstances of the leases, including:

- Effect on debt covenants, especially debt-to-equity and similar ratios
- Leases calling for contingent rental payments
- Related party leases
- Renewal options and lease inducements

For most nonpublic entities, this new standard is currently slated to be effective for fiscal periods beginning after December 15, 2019. It is important to consider the effect of this standard as soon as practical because all long-term leases will be subject to the new standard, not just new leases.

Other Changes

There are additional changes that occurred during the year that are less far-reaching or significant:

- Simplifications of the equity method of accounting for certain investments
- Adjustments to net asset classifications in nonprofits to include only unrestricted and restricted funds
- Reduced reporting requirements for nonprofits using the direct method for cash flows
- Disclosure of cost allocation method for nonprofits among program and support costs
- Accounting for credit losses

The Howard assurance team is always available to assist you with your questions regarding these new standards.

2017 TAX DEADLINES

Individual Returns:
April 18, 2017
Extended to October 16, 2017

Partnership Returns:
March 15, 2017
Extended to September 15, 2017

Trust and Estate Income Tax Returns:
April 18, 2017
Extended to October 2, 2017

C Corporation Returns:
April 18, 2017
Extended to October 16, 2017

S Corporation Returns:
March 15, 2017
Extended to September 15, 2017

"A fine is a tax for doing wrong.
A tax is a fine for doing well."

Meet Howard

Problem solvers. Trusted advisors.
For over 35 years, we've been providing valued services to individuals and businesses across multiple industries in Texas and around the world. Clients with tough issues know they can count on us for innovative ideas and helping them achieve their financial goals. We offer:

- Audit & Assurance
- Financial Consulting
- Tax Planning & Compliance
- IT Solutions

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