2015 Year-End Tax Planning Letter

Dear Clients and Friends,

At this point in 2015, with the end of the year and the income tax filing deadline on the horizon, tax planning presents more of a challenge than usual.

So far, Congress has passed minimal tax legislation. However, the Senate Finance Committee at the end of July approved a two-year extension of the tax provisions that expired on Dec. 31, 2014. Early passage of an extension is hoped for but not assumed because the House of Representatives is pursuing an agenda that would make the provisions permanent.

Contacting the IRS for guidance has become more difficult because budget cuts have resulted in personnel layoffs and reduction in services. On the bright side, your chances of facing an IRS audit are greatly reduced.

But the IRS continues to send out computer-generated notices, usually from document-matching processes. Since IRS notices generated in this way are sometimes incorrect, you should consult your tax professional about the appropriate response.

Never ignore an IRS notice. It won’t go away. Deal with it promptly to reduce any penalties and interest that may accrue.

Another issue that arose in 2015 is the vote by the House to repeal the estate tax. But the bill is languishing in congressional nether land as the Senate has shown little inclination to consider it.

An additional tax concern as the 2015 tax season and the year 2016 approach relates to the health insurance requirement. You should be aware that the penalty for failure to maintain qualifying health insurance shot up this year. The penalty is the greater of $325 for each adult and $162.50 for each child (not to exceed $975) or 2 percent of household income minus the amount of your tax-filing threshold.

For 2016, the penalty jumps to the greater of $695 per adult and $347.50 per child or 2.5 percent of income above the tax-filing threshold. After 2016, the penalty will be indexed for inflation.

As in most years, tax law changes – or possible changes – make it worthwhile for you to stay informed so you can minimize taxes or at least avoid missteps that could complicate your life.

Congress hampers tax planning

Once again, U.S. taxpayers are hampered in their tax planning efforts because of inaction on the part of Congress.

The tax cuts enacted in 2001 and 2003 included sunset provisions, so these cuts began to expire at the end of 2010. Since then, they have been extended for one or two years at a time. On Dec. 17, 2014, the cuts were extended for the tax year 2014 and expired on Dec. 31, 2014.

Currently, although the Senate Finance Committee has voted to extend the provisions for 2015, Congress will not address the possible legislation until later in the year. Such action is anticipated, but what exactly can be concluded for this year is unknown at this point. This is not an insignificant item since the tax impact of these expired provisions is significant for millions of taxpayers.

If the cuts are not extended, the result could be taxpayers owing the IRS rather than receiving a refund. At best, taxpayers' refunds would be smaller than anticipated.

Some of the more significant deductions in the list of expired extenders are:

- Deduction for state and local sales taxes in lieu of income taxes
- Tuition and fees deduction
- Expanded Section 179 deduction
- Special depreciation allowance, also known as Section 168(k) or "bonus" depreciation
- Educator expense deduction
- Exclusion of cancellation of debt income for qualified principal residence debt
- Deduction for mortgage insurance premiums
- Charitable contribution of an IRA
- Exclusion of gains on sale of small business stock
- Energy efficiency tax provisions

It's obvious that taxpayers across the spectrum are affected by these tax provisions. The delayed action on the part of Congress has left taxpayers with questions about how to proceed.

There are those in Congress that hear the voice of the taxpayer and are attempting to address these issues sooner rather than later. There is also a contingent in the House that would make the tax cuts permanent.

The best advice for taxpayers at this point is to:

- Make good business decisions, regardless of the tax implications.
- Reject a strategy that is dependent on Congress extending these provisions.
- Be ready to act if the cuts are extended.
- Keep in close communication with their CPA to stay abreast of any late-breaking tax developments.

IRS adjusts tax provisions for inflation

For 2015, the personal and dependency exemptions were increased to $4,000, from $3,950 in 2014. The standard deductions for all filing statuses received a small boost of between $100 and $200 above the 2014 amounts.

The annual health flexible spending account (FSA) contribution limit increased by $50 to $2,550. Both employee and employer may contribute to this account, but the combined contribution may not be greater than the annual limit.

Remember that the IRS modified the "use it or lose it" policy beginning in 2014 so that the employer, at its discretion, may allow employees to carry over to the following year up to $500 of unused funds in a health FSA account. An option is for an employer that does not permit the carryover to allow employees to have an extension, or grace period, of two-and-a-half months to use the remaining FSA money before losing it.

Employers may offer their employees only one of these health FSA options – or may choose to offer neither. You need to be aware of your employer's policy before the end of the year to avoid losing money left in your account.

Taxpayers who have a health savings account under a high-deductible health plan (HDHP) have higher contribution limits this year of $3,350 per individual and $6,650 for a family. The HDHPs' out-of-pocket maximums of $6,450 per individual and $12,900 for a family (see note below) and minimum deductibles of $1,300 per individual and $2,600 for a family are up somewhat from 2014.

Note: If you have an HDHP, you should confer with your CPA regarding out-of-pocket maximums because, in 2015, the IRS numbers and the Affordable Care Act numbers began to diverge, with the ACA maximums being slightly higher.

A good tax strategy is to participate in your employer's 401(k) plan. You may elect to contribute up to $18,000 this year before taxes, and the additional catch-up contribution for employees who are age 50 and above is $6,000. Refer to your employer's plan to confirm that the catch-up contribution is permitted. These increased contribution limits also apply to 403(b) plans, most 457 plans and the Thrift Savings Plan.

The IRA contribution limit was not raised in 2015. It is still $5,500, with an additional $1,000 catch-up contribution allowed for people 50 years of age or older.

But rules governing IRA rollovers have changed. As of 2015, you may make only one IRA-to-IRA rollover per year. This does not limit direct rollovers from trustee to trustee.

Any attempted rollover after the first one will be treated as a withdrawal and taxed at regular rates – with potentially a 10 percent early withdrawal penalty. The attempted rollover will be subject to regular IRA contribution limits, meaning that, if the amount of funds in the account exceeds your contribution limit, it will be subject to a 6 percent excise tax.

Whether the estate tax will be repealed is an unknown at this point. Currently, the estate tax exemption is $5.43 million. Together a married couple can pass an estate valued at $10.86 million to their heirs without paying federal estate tax because of the portability provision. Taxpayers will have to see what awaits them in 2016.

Estate tax planning is incredibly complex. It should be done in concert with a qualified financial adviser or CPA who specializes in estate and gift tax planning. You don't have to be wealthy to engage in estate tax planning. Middle-income couples have made mistakes in estate planning that cost them thousands of dollars.

Another inflation adjustment applies to foreign earned income. U.S. citizens and U.S. resident aliens who live abroad are taxed on worldwide income. If you worked outside of the United States this year, you may qualify for the foreign earned income exclusion, which means you may qualify to exclude from income for 2015 up to $100,800 of foreign earnings. This amount is adjusted annually for inflation. You may also exclude or deduct certain foreign housing amounts.

Note: Foreign earned income does not include any amounts paid by the United States or any of its agencies to its employees. Also, U.S. government employees paid by U.S. agencies that assigned them to perform specific services for foreign governments for which the foreign governments reimbursed the agencies do not qualify for an exclusion or a deduction.

Inflation Adjustments for 2015 Tax Provisions	
Standard Deduction	
Single or married filing separately	$6,300
Married filing jointly or surviving spouse	$12,600
Head of household	$9,250
Exemption Amount	$4,000
Flexible Spending Account Limitation	$2,550
Health Savings Account Limitation	
Single	$3,350
Family	$6,650
401(k) Limitation	$18,000
Plus catch-up contribution for age 50 & over, if permitted by employer plan	$6,000
Estate Tax Exemption	$5,430,000
Foreign Earned Income Exclusion	$100,800

Charitable deduction depends on qualified organization

As most taxpayers are aware, federal tax law allows a deduction for contributions made to qualified IRS tax-exempt organizations. Before making such contributions, however, you should become familiar with some of the laws and limitations on contributions so you can maximize the tax benefit of the deduction.

The contribution must be made to a qualified IRS tax-exempt organization. The IRS maintains an online tool (Exempt Organizations Select Check Tool) that simplifies the search for

organizations that meet the criteria. It should be noted that churches are not on this list as they are automatically exempt.

Also note that nonprofit status is granted by the state when the organization applies for its corporate charter as a nonprofit organization. Tax-exempt status is granted by the IRS upon application.

The donor cannot exercise undue control over the contribution. For example, you cannot make a contribution to a church, specifying that the funds be used to pay the medical bills of a good friend. A contribution may be made to the church benevolent fund with an expressed preference that the funds be used to help your friend, but the request may not be a condition of the gift.

The contribution must be made by Dec. 31. A check mailed with a Dec. 31 postmark is acceptable. The organization cannot "hold the books open" for a few days after the end of the year and credit those contributions to the year just ended.

There are limitations on the amount of charitable contributions that you may deduct. For individuals, the limit is 50 percent of adjusted gross income (AGI) or 30 percent of AGI if the donation is capital gain property. Any excess may be carried over to future years.

Corporations are limited to deducting 10 percent of the corporation's pretax net income. An S corporation carries the contribution to the individual shareholders' returns, so they are not subject to the 10 percent limitation.

Beyond the laws and limitations discussed above, some strategies may be employed to maximize the benefit of the deduction. If your itemized deductions are near the amount of the standard deduction, you may wish to bunch contributions in a year in which the standard deduction amount has been exceeded.

In addition, if your AGI exceeds a threshold amount, for example, $309,900 for married filing jointly, your charitable deduction amount will be phased out to not less than 80 percent of the contribution. If you have an unusually large income in a particular year, you may wish to defer your giving to another year to receive a greater benefit.

It is a good strategy to keep a running list of your charitable contributions so you can be prepared to speed up or delay any contributions to maximize your deductions. Along this same line, keeping tabs on your total income for the year, in case you will be subject to the phaseout provisions, will enable you to plan properly.

If you plan to contribute appreciated capital gain property, you will achieve the maximum benefit if the property is long-term – property held for more than 12 months. You can normally deduct the fair market value of the contribution rather than the cost basis. If held for 12 months or less, the deduction is limited to the basis in the property.

Before making such a contribution, you should ascertain that the property does qualify for deduction of the fair market value and is, in fact, appreciated property.

This overview provides some of the laws and strategies for deriving the maximum tax benefit from charitable contributions. Before making significant contributions, you would be wise to consult your CPA or tax professional to assure that you are maximizing the benefit.

Timing income and expenses can be important tax reduction strategy

As you consider your tax plan, determine whether you are likely to be subject to the alternative minimum tax (AMT). The AMT's function is to level taxes when income – adjusted for certain preference items – exceeds certain exemptions, but the tax rate applied to that income falls below the AMT rate.

Before deciding to accelerate or defer income and prepay or delay deductible expenses, you need to gauge the possible effect of the AMT on these tax-planning strategies. Having a number of miscellaneous itemized deductions, personal exemptions, medical expenses and state and local taxes can trigger AMT.

After analyzing your specific tax situation, if you anticipate that your income will be higher in 2016, you might benefit from accelerating income into 2015 and possibly postponing deductions, keeping the AMT threat in mind.

2015 AMT Rates and Exemption Amounts				
AMT Income		**Rate**		
$1-$185,400*		26%		
Over $185,400*		28%		
	Single	**Head of Household**	**Married Filing Jointly and Surviving Spouses**	**Married Filing Separately**
AMT Exemption Amount	$53,600	$53,600	$83,400	$41,700
Exemption Phaseout Begins	$119,200	$119,200	$158,900	$79,450
*Note: Married taxpayers filing separate returns should substitute $92,700 for $185,400 in the rate table.				

On the other hand, if you think you may be in a lower tax bracket in 2016, look for ways to defer some of your 2015 income. For example, you could delay into 2016:

- Collecting rents
- Receiving payments for services
- Accepting a year-end bonus
- Collecting business debts

And if you itemize deductions, consider prepaying some of your 2016 tax-deductible expenses in 2015.

Individuals usually account for taxes using the cash method. As a cash method taxpayer, you can deduct expenses when you pay them or charge them to your credit card. Expenses paid by credit card are considered paid in the year they are incurred.

In addition to charitable contributions discussed earlier, you should decide whether it would be beneficial for you to prepay the following expenses:

- **State and local income taxes** – You may prepay any state and local income taxes normally due on Jan. 15, 2016, if you do not expect to be subject to the AMT in 2015. If you reside in a state with high income and property taxes, you are more likely to be subject to the AMT because state taxes are not deductible when computing AMT income.
- **Real estate taxes** – You can prepay in 2015 any real estate tax due early in 2016. But you should keep in mind how the AMT could affect both years when preparing to pay real estate taxes on your residence or other personal real estate. However, real estate tax on rental property is deductible and can be safely prepaid even if you are subject to the AMT.
- **Mortgage interest** – Your ability to deduct prepaid interest has limits. But, to the extent your January mortgage payment reflects interest accrued as of Dec. 31, 2015, a payment before year-end will secure the interest deduction in 2015.
- **Margin interest** – If you bought securities on margin, any interest accrued as of Dec. 31, 2015, will be deductible in 2015 only if you actually pay the interest by Dec. 31 (subject to the investment interest limitation rules).
- **Miscellaneous itemized deductions** – You may deduct miscellaneous itemized deductions, like many deductions, only if you itemize your deductions and are not subject to the AMT. These deductions are different from other itemized deductions because the total amount of miscellaneous deductions must exceed 2 percent of your AGI to be deductible.

  Taxpayers usually elect to itemize deductions only if total deductions exceed the standard deduction for the year. If itemized deductions are near the standard deduction amount, grouping these deductions in alternating years is often an effective tax-planning strategy.

  Some expenses are deductible as itemized deductions only to the extent they exceed a specified percentage of your AGI.

  Taxpayers with unreimbursed medical and dental expenses may deduct the amount in excess of 10 percent of AGI. For taxpayers age 65 or older, the percentage is 7.5 percent, but this exception is temporary, slated to expire after Dec. 31, 2016.

  Also deductible are unreimbursed employee business expenses, tax return preparation fees, investment expenses and certain other miscellaneous itemized deductions that together are in excess of 2 percent of AGI.

  The amount of itemized deductions you can claim on your 2015 tax return is reduced by 3 percent of the amount by which your AGI exceeds the threshold amount:

2015 AGI Threshold	Filing Status
$258,250	Single taxpayers
$309,900	Married couples filing jointly
$284,050	Heads of household
$154,950	Married taxpayers filing separately

Taxpayers cannot lose more than 80 percent of the itemized deductions subject to the phaseout. And deductions for medical expenses, investment interest, casualty and theft losses, and gambling losses are not subject to the limitation.

Court ruling affects married same-sex couples' tax status

The recent Supreme Court decision legalizing same-sex marriages in all states may have an impact on how same-sex couples file their taxes. There may even be an opportunity to file amended returns for past years to achieve some tax savings.

On Sept. 23, 2013, the IRS issued Notice 2013-61, stating that the IRS would recognize marriages of same-sex couples whose marriage was legitimate in the state of residence for the couple. This obviously created a disparity among same-sex couples. Those in states that did not recognize such unions were unable to take advantage of the new ruling.

Presumably, most couples in this situation had filed single, with some filing as head of household. Under the court's ruling, they are now eligible for married filing jointly status. The decision opened this option for all legitimately married same-sex couples.

Note that couples living in states that did not previously recognize same-sex marriages are not considered married under this ruling. They must obtain a marriage license and be legally married in a marriage ceremony.

Couples who were residents of states recognizing same-sex marriages and filed tax returns using some status other than married filing jointly may file amended returns using Form 1040X for any year in which they were married and the statute of limitations remains open. This allows the filing of an amended return at any time prior to the later of three years after either the due date of the return or the date the return was actually filed. Since this is optional, couples should determine whether their tax liability will be reduced by filing the amended return.

For tax purposes, same-sex couples are treated the same as other couples. Their filing options are married filing jointly or married filing separately. Status as head of household or as single is not allowed for those who are married.

This Supreme Court ruling applies to all federal tax purposes in which marriage is a factor. Taxpayers who are uncertain about how to proceed with their taxes should consult a qualified CPA.

Employer questions and responsibilities abound

If you're a business owner, you are facing another year-end with more tax questions than answers.

One 2015 inflation adjustment applies to the small business healthcare tax credit. This year the maximum credit is phased out based on the employer's number of full-time equivalent employees in excess of 10 and the employer's average annual wages in excess of $25,800, which was $25,400 in 2014.

Of course, a major unknown right now is whether Congress will restore expired tax provisions retroactively to the beginning of 2015, providing some tax relief. Or will extender legislation get trapped somewhere between the Senate, the House and the Oval Office?

You can't stake the welfare of your business on possibilities, but there's some evidence that the following business tax provisions will be extended:

- Special 50 percent bonus depreciation
- Expanded Section 179 deduction
- R&D tax credit
- Section 179D energy efficiency deductions for commercial buildings
- Section 45L energy efficiency credits for multifamily and residential developers
- A 15-year depreciation recovery period for qualified real property

While you're waiting for the outcome of the extenders, you need to proceed with your standard tax filings, making sure that they are properly and timely filed.

Important guidance to keep in mind is the recently issued U.S. Department of Labor clarification of the definition of an independent contractor – as opposed to an employee. If you are classifying workers as independent contractors to reduce your health insurance obligations, your share of Social Security and Medicare payments and unemployment taxes, tread carefully.

If you classify some of your workers as independent contractors who are actually employees, your business could be required to pay unpaid payroll taxes and interest and penalties. It could also be obligated to pay for employee benefits that your company didn't previously provide, as well as federal penalties.

The basic guidance is an "economic realities test": How much control does your company have over the way workers perform their jobs? For example:

- Do the workers in question determine how they accomplish their task, or do you closely supervise them?
- Do they have other clients, or do they work full-time for you?
- Do they receive payment for each job, or do you pay them on your schedule?
- Do they own their own equipment and facilities, or does your company provide equipment, supplies and office space?

These and other considerations are important in determining a worker's status. If you have any questions, consult with your CPA about the proper classification of your workers to avoid additional taxes and penalties.

For each independent contractor paid $600 or more this year, you are responsible for reporting the pay on a Form 1099-MISC.

An employer must provide Forms W-2 to employees by Jan. 31, or the first Monday following that date, for the previous calendar year. Copies are submitted, along with transmittal Forms W-3, to the Social Security Administration by the last day in February. However, if the W-2 copies are being filed electronically, the employer has until the last day of March to file.

Failing to file properly incurs some stiff penalties. Failure to file correct returns by the due date subjects the employer to fines of $30 to $100 per form. If there is an intentional disregard of the filing or correct information requirements, the fine is at least $250 for each form. Failure to furnish correct statements to employees without reasonable cause can subject the employer to an unspecified penalty, depending on when the correct statement is filed.

It should be noted that the IRS prohibits advertising on a Form W-2, and a form containing advertising is not considered a correct form.

Companies are also required to file a Form 1099 in many instances when a payment has been made to certain third parties. The variations of the 1099 are many, but the 1099-MISC is most common. This form must be filed if the business has paid above the threshold-level amounts for rents, services paid to someone who is not an employee, prizes, certain other income, medical and healthcare payments, among other payments.

Copies of Forms 1099 should be provided to the recipient by Jan. 31 or the first Monday following that date. However, this deadline is frequently disregarded because of corrected forms or other issues.

The Form 1096, which is the transmittal form for Form 1099 and other information returns, generally must be filed on the same schedule as the W-2. These are filed with the IRS, not the Social Security Administration.

Because of the sometimes transient nature of recipients of a 1099, or because a comprehensive tracking system is lacking, companies may overlook issuing a 1099 on a timely basis. For example, the company has filed its forms on a timely basis and given its accounting records to the CPA to prepare the company income tax returns. The CPA discovers three instances in which the company did not issue a 1099 that was required by law.

Should the company file the forms and send in a “corrected” 1096? Absolutely not. The IRS instructions state that if an employer discovers that additional forms must be issued, the new 1096 should be filed, containing only the information relating to the late-filed forms.

Conclusion

The U.S. Tax Code is incredibly complex and can change rapidly, even though it may sometimes seem to be moving along at a snail’s pace. This complexity has given rise to more calls for simplification. For now, taxpayers must still live with the complexity and the changes, as simplification appears to be only a dream.

Although a majority of taxpayers have their taxes prepared by a professional, they are turning in larger numbers to self-prepared returns. Since the online program does the calculations, it seems to be an economical approach to preparing and filing taxes.

However, the program is no substitute for a qualified tax professional such as a CPA. Programs can calculate tax liability, but they cannot substitute for professional advice and guidance.

With such complexity in the Tax Code, a CPA is better able to keep abreast of the changes and can prepare taxes in a manner that determines a taxpayer's minimum legal tax liability. But minimizing tax liability started last week, last month, last year. Tax planning is a constant in today's complex world.

The technical information in this newsletter is necessarily brief. No final conclusion on these topics should be drawn without further review and consultation. © 2015 CPAmerica International