2015-2016 TAX UPDATE:
The PATH to Lower Taxes

By Olga Zarney, CPA, MST, Tax Manager

INDIVIDUAL TAXATION

Congress has struck yet again, this time to the taxpayers’ advantage. New legislation was passed, the Protecting Americans from Tax Hikes (PATH) Act of 2015, that retroactively reinstates for 2015 the tax extenders that expired at the end of 2014. Unlike past tax legislation, many of the provisions are now renewed and made permanent. A number of other provisions are extended through 2016, while others are extended through 2019.

For individuals, the permanent tax breaks include:

- An option to deduct state and local sales and use taxes instead of state and local income taxes
- An above-the-line deduction for educator expenses
- A tax-free distribution of up to $100,000 transferred directly from an IRA to a charitable organization by individuals age 70 ½ or older

The following credits that were set to expire in 2017 are also made permanent:

- The enhanced American Opportunity Tax Credit
- The enhanced earned income tax credit
- The enhanced child tax credit

The following individual tax breaks are extended through 2016:

- An exclusion of up to $2 million in mortgage debt forgiveness on a principal residence
- An above-the-line deduction for qualified higher education expenses
- A deduction for mortgage insurance premiums, subject to phase-out based on income

Before year-end, taxpayers can still take additional steps to save taxes and expand into specific strategies aimed at achieving personal financial goals, especially in the areas of philanthropy, family, and retirement.

The current individual income tax rate structure is not scheduled to change for 2015. For 2016, the rates will be subject to inflation adjustments. The current tax treatment of capital gains and qualified dividends will most likely stay in place for 2016.

As in the past year, higher-income taxpayers must be aware of the 3.8% tax on net investment income, which includes dividends, rents, interest, passive activity income, capital gains, annuities and royalties. In addition, the 0.9% Medicare tax applies to individuals receiving wages and/or self-employment income in excess of $200,000 ($250,000 for married couples filing jointly and $125,000 for married couples filing separately).

Some ways to limit exposure to the 3.8% tax on net investment income are to harvest capital losses that will offset capital gains or to use an installment sale to spread out a larger gain. Taxpayers who sell their securities at a loss should be careful not to repurchase the same securities within 30 days before or after the sale to avoid “wash sale” limitations. Taxpayers facing large capital gains can also consider donating long-term appreciated capital assets to charitable organizations. This will enable the taxpayer to avoid both the capital gains tax and the 3.8% net investment income tax that would have been incurred had the assets been sold.

Taxpayers who anticipate being in a lower tax bracket in 2016 may want to postpone some of their 2015 income until 2016. It may be advantageous to try to arrange with an employer to defer a bonus until after December 31, 2015. Self-employed taxpayers may defer billings and collections until January 2016.

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Taxpayers may also want to accelerate certain deductions into 2015 in order to lower their 2015 taxes by:

- Prepaying the 2nd installment of property taxes in December
- Paying the January mortgage before December 31st in order to deduct interest on the 2015 tax return
- Making a 4th quarter state estimated tax payment by December 31st
- Accelerating charitable contributions
- Using a credit card to pay deductible expenses, such as medical expenditures, before the end of the year; doing so will increase 2015 deductions even though the credit card bill may not be paid until after the end of the year.

However, taxpayers should be cautious about how year-end planning strategies could impact Alternative Minimum Tax (AMT). Many of the deductions allowed for purposes of calculating regular taxes are disallowed for AMT purposes. These include the deduction for state property taxes, state income taxes, miscellaneous itemized deductions, and personal exemption deductions. Other deductions, such as the medical expenses of a taxpayer who is at least age 65 or whose spouse is at least 65 as of the close of the tax year, are calculated in a more restrictive way for AMT purposes than for regular tax purposes. If a taxpayer may be subject to the AMT for 2015, these types of deductions should not be accelerated.

The AMT exemption for 2016 will increase to $53,900 and begin to phase out at $119,700 for single taxpayers ($83,800 for married couples filing jointly, phasing out at $159,700).

**RETIREMENT PLANNING STRATEGIES**

Some of the other year-end strategies to consider are setting up and contributing to a retirement plan. Deductible contributions to a traditional IRA and pretax contributions to an employer-sponsored retirement plan, such as a 401(k), could reduce the taxpayer’s 2015 taxable income. In order for contributions to be deductible in 2015, most 401(k) plans must be set up prior to the end of the year and plan contributions must be made by the taxpayers’ paychecks or year-end bonuses by December 31, 2015. Some retirement plans can be set up and funded in 2016, while still allowing a 2015 deduction. For additional information on the various retirement plans and maximum allowable contributions see [Start Saving for Retirement – No Matter When](#) in our Fall 2015 newsletter.

Taxpayers age 70½ or older must take required minimum distributions (RMDs) from their retirement accounts before the end of the year. Taxpayers who turned 70½ in 2015 may delay the first required distribution until April 1, 2016, but in doing so, they will have to take a double distribution in 2016; the amount required for 2015 plus the amount required for 2016. Failure to take a required withdrawal can result in a penalty of 50% of the amount of the RMD not withdrawn. Taxpayers who are over 70½ may want to consider making year-end charitable gifts directly from their IRA RMD; this distribution will be tax-free.

In some situations, retired taxpayers may benefit from taking additional distributions from their retirement accounts. A detailed tax projection will reveal if additional distributions may generate little or no additional tax, depending on individual tax circumstances.

**IRA ROLLOVER STRATEGIES**

Typically, any amount distributed from an IRA will not be included in the gross income of the recipient to the extent that the amount is contributed to another retirement plan. This contribution to another retirement plan is called a “rollover contribution” if the owner receives a check and does not use a trustee-to-trustee transfer. The Internal Revenue Code provides that, in order to receive tax-free rollover treatment, the rollover contribution generally must be made by the 60th day after the recipient receives the distribution.

**Effective January 1, 2015, an individual is permitted to make only one rollover contribution in any one year period, regardless of how many IRA accounts they hold.** Thus, if a taxpayer has two IRAs at two different banks and rolls over one of the IRAs, the second IRA can no longer be rolled over during the same year regardless of where it is held.

The one-rollover-per-year limitation does not affect the ability of an IRA owner to transfer funds via a direct trustee-to-trustee transfer from one IRA trustee directly to another IRA trustee. Because there is no distribution to the owner, the transfer is tax-free. Since it is not considered to be a rollover, it is not affected by the one-year waiting period between rollovers.

**GIFT/ESTATE PLANNING**

Taxpayers can potentially save on gift and estate taxes by making annual tax-free gifts of up to $14,000 per recipient. Married taxpayers can split gifts for a total of $28,000 per recipient. Additional gifts can be made using the lifetime gift exemption amount which is $5.43 million for 2015 and $5.45 million for 2016. Taxpayers can also make unlimited payments directly to medical providers or educational institutions on behalf of others without incurring a taxable gift or using their lifetime gift-tax exemption.

**AFFORDABLE CARE ACT**

The Affordable Care Act (ACA) created substantial health care reform that taxpayers should take into consideration with respect to tax planning. Beginning in January 1, 2014, the ACA required that all individuals either maintain health care coverage, have an exemption from the requirement to have coverage, or make a penalty payment when filing their tax returns. In 2015 the penalty increases to the greater of $325 or 2% of household income. In 2016 the penalty increases to the greater of $695 or 2.5% of household income. The penalty will be indexed for inflation after 2016. The penalty for dependents under age 18 is half the penalty of an adult individual.

**CHANGING LIFE CIRCUMSTANCES**

If a taxpayer’s circumstances have changed or will be changing, such as marriage, divorce, birth or adoption of a child, retirement, purchase of a residence, change in filing status, or other life events, this may impact year-end tax planning.
BUSINESS TAXATION

Just as individual taxpayers benefit from the extended tax breaks, so do businesses. Their permanently extended tax breaks include:

- Research and development tax credit
- Increased limit of $500,000 for Section 179 deduction
- 15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements
- An exclusion of 100% of gain on certain small business stock
- A reduction in S Corporation recognition period to 5 years for built-in gains

The 50% bonus first-year depreciation for most new machines, equipment, software, and qualified leasehold improvements, is extended through 2017. The exclusion percentage phases down to 40% in 2018 and 30% in 2019.

Some real estate taxpayers may consider utilizing a cost segregation study to separate personal property assets from real property assets in order to accelerate depreciation deductions. The process is a detailed review of the depreciable components of a building that identifies personal property assets that are grouped with real property assets, and separates out personal assets for tax reporting purposes.

To reduce 2015 taxes, businesses may want to accelerate deductions into 2015 and postpone income to 2016. For cash basis business taxpayers, this can be done by delaying the sending of late-in-the-year invoices, so that payment is not received until 2016. Accrual basis business taxpayers can postpone providing goods or services to customers until after January 1, 2016. In order to accelerate deductions to 2015, business taxpayers can maximize spending on supplies, equipment and vehicle repair, and other deductible expenses that would have been incurred in 2016 anyway. Cash basis business taxpayers may consider paying bonuses before year-end. Accrual basis business taxpayers may be able to deduct employee bonuses that they plan to pay within 2½ months of 2016.

Some businesses may want to consider accelerating income from 2016 to 2015. For example, if a corporation (other than a “large” corporation) anticipates a small net operating loss (NOL) for 2015 and substantial net income in 2016, it may want to accelerate just enough of its 2016 income or to defer just enough of its 2015 deductions to create a small amount of net income for 2015. This will permit the corporation to base its 2016 estimated tax installments on the relatively small amount of income shown on its 2015 return, rather than having to pay estimated taxes based on 100% of its much larger 2016 taxable income.

IRS TANGIBLE PROPERTY REGULATIONS

It has been a full tax year since taxpayers were impacted by the new IRS Tangible Property Regulations (TPRs). The TPRs provided a general framework for distinguishing capital expenditures from supplies, repairs, maintenance, and other deductible business expenses. These regulations apply to all forms of businesses, whether a corporation, a partnership, an LLC, a sole proprietorship (Schedule C on an individual return), or a rental property (Schedule E on an individual return). Taxpayers are encouraged to review their asset capitalization policies to ensure they are in compliance with the new regulations. Beginning January 1, 2016, the IRS has raised the safe harbor threshold for deducting certain capital items from $500 to $2,500. The change affects businesses that do not maintain an applicable financial statement. It applies to amounts spent to acquire, produce or improve tangible property that would normally qualify as a capital item. Businesses may be able to take advantage of this revised “de minimis safe harbor election” to expense, rather than capitalize, the costs of inexpensive assets, materials and supplies.

AFFORDABLE CARE ACT

The Affordable Care Act also imposed complex and varying requirements on businesses. For 2015, Applicable Large Employers, those that employ 100 or more full-time equivalent employees, must provide insurance coverage to at least 70% of their full-time equivalent employees who meet certain minimum requirements, or face a penalty. Beginning January 1, 2016, this employer mandate will take effect for employers with at least 50 full-time equivalent employees, and the required percentage of covered employees increases to 95%. Additionally, employers are required to report coverage information both to the employee and to the IRS on new Form 1095-C. An employer filing 250 or more Forms 1095-C must file electronically. The form must be provided to employees annually no later than January 31st, and to the IRS no later than the last day of February if paper filed, or the last day of March if filed electronically.

California does not conform to many of these tax breaks. Please contact us to address your individual or business situation and for assistance with tax planning.

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Estate planning can be an uncomfortable topic to bring up, especially around the holidays. However, a well-prepared estate plan can ensure that your loved ones are provided for and alleviate some of the inevitable stress. Here are 10 things to consider when developing your plan:

1. **Valid Will and Trusts:** Your will is the foundation of your estate plan; your trust can keep your estate out of probate court, which, in Los Angeles, could be a long process. If you’ve been holding onto an unsigned, marked-up draft from your attorney, now is the time to finalize it and have a signed, valid copy.

2. **Updated Will and/or Trust:** If there have been any major life events, such as marriage, divorce, separation, children, or death since the last update, you should consider revising your will and/or trust. Now is also the time to add, change, or delete any beneficiaries as desired.

3. **Caretaking of Others:** If there are any individuals, such as a niece or a nephew, a friend, or others, whom you plan to support after your death, include them in your plan.

4. **Holding Title Correctly:** If you have a trust, ensure the assets that belong in the trust are properly titled in the name of the trust.

5. **Executor or Trustee:** Check that the named executor or trustee is still willing and able to perform their duties, and that they are aware of their responsibilities in that role.

6. **Personal Items:** Include in the will or create a separate list of personal items, such as family heirlooms, that you would like to pass on to specific people. Let someone know where this list is located.

7. **Assets Outside Your Will or Trust:** Assets such as your retirement account, insurance policies, and pension plans should be updated with current beneficiary designations. Any pay-on-death bank accounts should be made known to the beneficiaries of these accounts.

8. **Last Minute Gifting:** It may be advantageous to transfer assets out of your estate to your children or others before year-end and/or develop a gifting plan for the future.

9. **Passwords for Online Accounts:** Ensure that someone is able to access your monthly bill-paying websites so that regular payments can continue to be made on items such as utilities, mortgage, and credit cards. Additionally, provide access for the online storage of family photos and your social media accounts (Facebook, Twitter, YouTube, LinkedIn, etc.). Letting a loved one know how to log in may prevent your family from losing precious photo memories.

10. **Final Arrangements:** You may want to consider creating a pre-need plan to ensure your final wishes will be carried out by either making all the arrangements yourself before your death or sharing your wishes with your loved ones. Thinking ahead can spare your survivors the stress of making these decisions for you during a difficult period and possibly under time pressure.

Estate planning can be complex. We can work with your attorney to develop a plan that fits your individual situation. An estate plan will give you and your family peace of mind, and there is no better gift to give this holiday season.

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**NSBN LLP Announces Kenneth A. Miles, CPA, Elected to Deputy Worldwide Chairman of Alliott Group**

Kenneth A. Miles, CPA, Managing Partner of NSBN, was elected by Alliott Group to serve as Deputy Worldwide Chairman, in addition to Chairman of the North America Region. Alliott Group, an international association of law, accounting and consulting firms, extends NSBN’s ability to serve clients across borders and provides access to resources typically available to only the largest accounting firms.