Miller Verchota, Inc.
Certified Public Accountants

2015 YEAR-END TAX PLANNING

Before we get to specific suggestions, here are two important considerations to keep in mind.

1. **Remember that effective tax planning requires considering both this year and next year**—at least. Without a multiyear outlook, you can't be sure maneuvers intended to save taxes on your 2015 return won't backfire and cost additional money in the future.
2. Be on the alert for the Alternative Minimum Tax (AMT) in all of your planning, because what may be a great move for regular tax purposes may create or increase an AMT problem. There's a good chance you'll be hit with AMT if you deduct a significant amount of state and local taxes, claim multiple dependents, exercised incentive stock options, or recognized a large capital gain this year.

TRADITIONAL YEAR-END STRATEGIES

Traditional year-end planning techniques remain important both to maximize benefits in connection with what's new and to do so within the usual ebb and flow of the taxpayer's personal economy.

The following traditional income and deduction acceleration techniques and their reciprocal deferral strategies should be considered:

Income Deferral/Acceleration:

- Delay/ Accelerate billable services
- Enter into/ Sell installment contracts
- Defer/ Receive bonuses before January
- Hold/ Sell appreciated assets
- Accelerate income to use available carryforward losses
- Hold/ Redeem U.S. Savings Bonds
- Delay/ Accelerate debt forgiveness income
- Minimize/ Maximize retirement distributions (Consider a Roth conversion)
- Roth conversion/Recharacterize an earlier Roth conversion if market value dropped
- Structure/ Avoid mandatory like-kind exchange treatment

Deductions and Credits Acceleration/Deferral:

- Bunch itemized deductions into 2015 and take standard deduction in 2016/ reverse steps
- Pay bills in 2015(by check or bank credit card)/ postpone payments until 2016
- Pay last state estimated tax installment in 2015/ delay payment until 2016
- Watch AGI limitations on deductions/credits
- Watch net investment interest restrictions
- Match passive activity income and losses

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Business Planning

Businesses seeking to maximize tax benefits through 2015 year-end tax planning may want to consider several general strategies, such as use of traditional **timing techniques for income and deductions** and the role of the **tax extenders (if renewed** and in the event they are not renewed), as well as strategies targeted to their particular business. As in past years, planning is uncertain because of the expiration of many popular but temporary tax breaks. Also added to the mix is the far-reaching Affordable Care Act (ACA).

Expensing and Bonus Depreciation

Many businesses have utilized enhanced Code Sec. 179 expensing as a key component of year-end tax planning. Code Sec. 179 property is generally defined as **new or used** depreciable tangible Code Sec. 1245 property (equipment) that is **purchased for use in** the active conduct of a **trade or business**. In 2014, off-the-shelf computer software was also included as was qualified real property (qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property). At the time this letter was prepared, the enhancements to Code **Sec. 179 expensing had not been renewed by Congress for 2015 but the likelihood is very high that they will be renewed** (at the $500,000 annual expensing limitation allowed in 2014). Year-end planning should reflect both the likely extension, and the possibility of no extension (current law in effect for tax years beginning in 2015, the expensing limit is $25,000).

Similarly, bonus depreciation has been a valuable incentive for many businesses. **Fifty percent bonus depreciation generally expired after 2014** (with limited exceptions for certain types of property). Qualified property for bonus depreciation purposes must be depreciable under the Modified Accelerated Cost Recovery System (MACRS) and have a recovery period of 20 years or less. These requirements encompass a wide variety of assets. Year-end placed-in-service strategies therefore can provide an almost immediate "cash discount" for qualifying purchases. Although a bonus-depreciation election should be factored into a year-end strategy, a final decision on making it is not required until a return is filed. Further, bonus depreciation is not mandatory. Certain taxpayers should consider electing out of bonus depreciation to spread depreciation deductions more evenly over future years.

Returning to Code Sec. 179 expensing, one potentially useful strategy is to **maximize benefits under Code Sec. 179 by expensing property that does not qualify for bonus depreciation (such as used property)** and property with a long MACRS depreciation period. For example, given the choice between expensing an item of MACRS five-year property and an item of MACRS 15-year property, the 15-year property should generally be expensed since it takes 10 additional tax years to recover its cost through annual depreciation deductions as opposed to recovery of the cost of the five-year property.

Repair-capitalization rules

Another valuable incentive for year-end planning is the de minimis safe harbor threshold amount under the final "repair regs" for taxpayers. Currently, a de minimis safe harbor under the repair regs **allows taxpayers to deduct certain items costing $5,000 or less** (per item or invoice) and that are deductible in accordance with the company's accounting policy reflected on their applicable financial statement (certified audited financial statement). IRS regulations also provide a $2500 de minimis safe harbor threshold for taxpayers without an applicable financial statement.

Affordable Care Act

Businesses large and small continue to work to comply with the ACA. For large businesses (generally known as applicable large employers or ALEs), the ACA imposes a number of new requirements, including the employer shared responsibility provision (also known as the employer mandate). Small businesses, although generally exempt from the employer mandate, need to review how they deliver health insurance (if offered) to their employers.

Many small businesses have traditionally provided a health benefit to their employees through a **health reimbursement arrangement (HRA).** Following passage of the ACA, the IRS described certain types of HRAs as employer payment plans. Therefore, they are considered to be group health plans subject to the ACA's market reforms, including the prohibition on annual limits for essential health benefits and the requirement to provide certain preventive care without cost sharing. Failure to comply with the ACA's market reforms triggers excise taxes under Code Sec. 4980D. This announcement by the IRS has left many small businesses uncertain how to proceed. **There is pending legislation in Congress that would allow small employers (employers with less than 50 full-time and full-time equivalent employees) to have stand-alone HRAs and reimburse expenses without violating the ACA's market reforms.** Our office will keep you posted on developments.

Small employers with **no more than 25 full-time equivalent employees** may qualify for a special **tax credit to help offset the cost of health insurance** for their employees. The employer must pay average annual wages of no more than $50,000 per employee (indexed for inflation) and maintain a qualifying health care insurance arrangement. Generally, health insurance for employees must be obtained through the Small Business Health Options Program (SHOP), which is part of the Health Insurance Marketplace.

Employ Your Child

If you are self-employed, don't miss one last opportunity to employ your child before the end of the year. Doing so has tax benefits in that it shifts income (which is not subject to the Kiddie tax) from you to your child, who normally is in a lower tax bracket or may avoid tax entirely due to the standard deduction. There can also be payroll tax savings since wages paid by sole proprietors to their children under age 18 are exempt from social security and unemployment taxes. Employing your children has the added benefit of providing them with earned income, which enables them contribute to an IRA. The compounded growth in an IRA started at a young age can be a significant jump start to the child's retirement savings. Remember a couple of things when employing your child. First, the wages paid must be reasonable given the child's age and work skills. Second, if the child is in college, or is entering soon, having too much earned income can have a detrimental impact on the student's need-based financial aid eligibility.

Check Your Partnership and S Corporation Stock Basis

If you own an interest in a partnership or S corporation, your **ability to deduct any losses it passes through is limited to your basis**. Although any unused loss can be carried forward indefinitely, the time value of money diminishes the usefulness of these suspended deductions. Thus, if you expect the partnership or S corporation to generate a loss this year and you lack sufficient basis to claim a full deduction, you **may want to make a capital contribution** (or in the case of an S corporation, loan it additional funds) before year end.

Avoid the Hobby Loss Rules

A lot of businesses that are just starting out or have hit a bump in the road may wind up **showing a loss for the year**. The last thing the business owner wants in this situation is for the IRS to come knocking on the door arguing the business's losses aren't deductible because the activity is just a hobby for the owner. The IRS has been fairly successful in making this argument when it takes taxpayers to court. Thus, if your business is expecting a loss this year, we should talk before year-end to make sure we do everything possible to maximize the tax benefit of the loss and minimize its economic impact.

INDIVIDUAL PLANNING

For individuals, the **income tax rates for 2015 are unchanged from 2014: 10, 15, 25, 28, 33, 35 and 39.6 percent**. The top tax rate for qualified capital gains and dividends is also unchanged from 2014: 20 percent. Year-end planning should look to avoiding spikes in income, whether capital gains or other income, which for higher-income taxpayers may push capital gains into either the 39.6 percent bracket for short-term gains or the 20 percent capital gains bracket for long-term gains. Spreading the recognition of certain income between 2015 and 2016 may accomplish this goal.

Managing Your Adjusted Gross Income (AGI)

Many tax deductions and credits are subject to AGI-based phase-out, which means only taxpayers with AGI below certain levels benefit. [**AGI is the amount at the bottom of page 1 of your Form 1040—basically your gross income less certain adjustments** (i.e., deductions), but *before* itemized deductions and the deduction for personal exemptions.] Unfortunately, however, the applicable AGI amounts differ depending on the particular deduction or credit. The following table shows a few of the more common deductions and credits and the applicable AGI phase-out ranges for 2015:

	Adjusted Gross Income Phase-out Range		
Deduction or Credit	**Joint Return**	**Single/Head of Household (HOH)**	**Married Filing Separate**
American Opportunity Tax Credit	$160,000–$180,000	$80,000–$90,000	No credit
Child Tax Credit	Begins at $110,000	Begins at $75,000	Begins at $55,000
Itemized Deduction and Personal Exemption Reduction	Begins at $309,900	Begins at $258,250 Single, $284,050 HOH	Begins at $154,950
Lifetime Learning Credit	$110,000–$130,000	$55,000–$65,000	No credit
Passive Rental Loss ($25,000) Exception	$100,000–$150,000	$100,000–$150,000	No exception unless spouses live apart
Student Loan Interest Deduction	$130,000–$160,000	$65,000–$80,000	No deduction

Managing your AGI can also help you avoid (or reduce the impact of) the 3.8% net investment income tax that potentially applies if your AGI exceeds $250,000 for joint returns, $200,000 for unmarried taxpayers.

Managing your AGI can be somewhat difficult, since it is not affected by many deductions you can control, such as deductions for charitable contributions and real estate and state income taxes. However, you **can effectively reduce your AGI** by increasing "above-the-line" deductions, such as those for **IRA or self-employed retirement plan contributions**. Consider **disposing of a passive activity in 2015** if doing so will allow you to deduct suspended passive activity losses. For sales of property, consider an **installment sale that shifts part of the gain to later years** when the installment payments are received or use a **like-kind exchange** that defers the gain until the exchanged property is sold. If you own a cash-basis business, delay billings so payments aren't received until 2016 or **accelerate paying of certain expenses**, such as office supplies and repairs and maintenance, to 2015. Of course, before deferring income, you must assess the risk of doing so.

Net Investment Income (NII) Tax

Since 2013, taxpayers with qualifying income are liable for the **3.8 percent net investment income (NII) tax**. The threshold amounts for the NII tax are:

- $250,000 in the case of joint returns or a surviving spouse,
- $125,000 in the case of a married taxpayer filing a separate return, and
- $200,000 in any other case.

All net investment income should be monitored for exposure to the NII tax. Net investment income is more than simply **capital gains and dividends**. It also includes **income from a business in which the taxpayer is a passive participant. Rental income** may also be considered NII unless earned by a real estate professional. Taxpayers with potential NII liability should consider keeping income below the $250,000/$125,000/$200,000 thresholds if possible by spreading income out over a number of years or offsetting the income with both above-the-line and itemized deductions.

Additional Medicare Tax

The Additional Medicare Tax increases the employee share of Medicare tax by **an additional 0.9 percent of covered wages** in excess of certain threshold amounts. The tax also increases Medicare tax on self-employment income by an additional 0.9 percent of self-employment income in excess of the threshold amounts. The threshold amounts are:

- $200,000 for single individuals (and heads of household);
- $250,000 for married couples filing a joint return; and
- $125,000 for married individuals filing separate returns.

This is now the third year in which affected taxpayers will file returns reflecting Additional Medicare Tax. Taxpayers who only now realize that they have had insufficient income tax withholding may request that their employer(s) take out an additional amount of income tax withholding, which would be applied against taxes shown on the taxpayer's individual income tax return, including any Additional Medicare Tax liability. Taxpayers may also consider making estimated tax payments.

Alternative Minimum Tax

Taxpayers should continue to review their AMT liability versus regular tax liability. Many tax **deductions** allowed for purposes of calculating regular taxes are **disallowed for AMT** purposes. These include the deductions for **state property and income taxes**. For some taxpayers, AMT liability and

regular tax liability may be roughly equal from year to year. Other taxpayers may find that they have had significant fluctuations in income or AMT-targeted tax benefits from year to year and could explore the benefit from being able to shift some AMT-triggering items from an AMT year to a non-AMT year.

Pease Limitation/PEP

The Pease limitation **reduces the total amount of a higher-income taxpayer's** otherwise allowable **itemized deductions** by three percent of the amount by which the taxpayer's adjusted gross income exceeds an applicable threshold. However, the amount of itemized deductions is not reduced by more than 80 percent. Taxpayers who find themselves within threshold adjusted gross income amounts that make them subject to the Pease Limitation will also need to plan for the revived personal exemption phaseout (PEP).

Individual Tax Extenders

As was the case at the end of 2014 – the individual extenders (as well as the business extenders discussed below) – are **unavailable for 2015** and subsequent years, **unless extended by Congress**. For individuals, they include the:

- state and local sales tax deduction,
- up-to-$2 million mortgage debt forgiveness on principal residence,
- higher education tuition deduction,
- tax-free IRA distributions to charities by those 70-1/2 or older, and
- $250 teachers' classroom expense deduction.

Affordable Care Act

Effective January 1, 2014, the PPACA requires individuals, unless exempt, to carry **minimum essential health insurance coverage for each month or make an individual shared responsibility payment**. Individuals liable for a shared responsibility payment during 2015 will make their payment when they file their 2015 returns. Individuals who obtain health insurance coverage through the PPACA Marketplace may be eligible for the Code Sec. 36B premium assistance tax credit to help offset the cost of coverage. 2014 was the first year that the Code Sec. 36B credit was available. Taxpayers who elect to receive advance payments of the Code Sec. 36B credit must reconcile on their returns the amount forwarded to insurers with the credit they may claim.

Year-End Retirement Strategies

Take required minimum distributions (RMDs) from your IRA or 401(k) plan (or other employer-sponsored retirement plan). **RMDs from IRAs must begin by April 1 of the year following the year you reach age 70-1/2**. That start date also applies to company plans, but non-5% company owners who continue working may defer RMDs until April 1 following the year they retire. Failure to take a required withdrawal can result in a penalty of 50% of the amount of the RMD not withdrawn. If you turned age 70-1/2 in 2015, you can delay the first required distribution to 2016, but if you do, you will have to take a double distribution in 2016 — the amount required for 2015 plus the amount required for 2016. **Think twice before delaying 2015 distributions to 2016, as bunching income into 2016 might push you into a higher tax bracket** or have a detrimental impact on various income tax deductions that are reduced at higher income levels. However, it could be beneficial to take both distributions in 2016 if you will be in a substantially lower bracket that year.

It May Pay to Wait until the End of the Year to Take Your Distributions.

If you plan on making additional charitable contributions this year and you have not yet received your 2015 required distribution from your IRA, you might want to wait until the very end of the year to do both. It is **possible that the Congress will bring back the popular Qualified Charitable Distributions (QCDs) that expired at the end of 2014**. If so, IRA owners and beneficiaries who have reached age 70½ will be able to **make cash donations totaling up to $100,000 to IRS-approved public charities directly out of their IRAs**. QCDs are federal-income-tax-free to you and they can qualify as part of your required distribution, but you get no itemized charitable write-off on your Form 1040. That's okay because the tax-free treatment of QCDs equates to an immediate 100% federal income tax deduction without having to itemize your deductions or worry about restrictions that can reduce or delay itemized charitable write-offs. However, to qualify for this special tax break, the **funds must be *transferred directly* from your IRA to the charity**. Once you receive the cash, the distribution is not a QCD and won't qualify for this tax break.

Charitable Giving

You might want to consider two charitable giving strategies that can help boost your 2015 charitable contributions deduction. First, **donations charged to a credit card** are deductible in the year charged, not when payment is made on the card. Thus, charging donations to your credit card before year-end enables you to increase your 2015 charitable donations deduction even if you're temporarily short on cash.

Another charitable giving approach you might want to consider is the **donor-advised fund.** These funds essentially allow you to obtain an immediate tax deduction for setting aside funds that will be used for future charitable donations. With these arrangements, which are available through a number of major mutual fund companies, as well as universities and community foundations, you contribute money or securities to an account established in your name. You then choose among investment options and, on your own timetable, recommend grants to charities of your choice. The minimum for establishing a donor-advised fund is often $10,000 or more, but these funds can make sense if you want to obtain a tax deduction now but take your time in determining or making payments to the recipient charity or charities. These funds can also be a way to establish a family philanthropic legacy without incurring the administrative costs and headaches of establishing a private foundation.

Adjust Your Federal Income Tax Withholding

If it looks like you are going to owe income taxes for 2015, consider bumping up the federal income taxes withheld from paychecks and retirement distributions from now through the end of the year. When you file your return, you will still have to pay any taxes due less the amount paid in. However, as long as your total tax payments (estimated payments plus withholdings) equal at least 90% of your 2015 liability or, if smaller, 100% of your 2014 liability (110% if your 2014 adjusted gross income exceeded $150,000; $75,000 for married individuals who filed separate returns), **penalties will be minimized, if not eliminated**.

Take an eligible rollover distribution from a qualified retirement plan before the end of 2015 if you are facing a penalty for underpayment of estimated tax and **having your employer increase your withholding is unavailable** or won't sufficiently address the problem. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2015. You can then timely (within 60 days) roll over the gross amount of the distribution, i.e., the net amount you received plus the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2015, but the withheld tax will be applied pro rata over the full 2015 tax year to reduce previous underpayments of estimated tax.

Estate and Gift Taxes

The maximum federal unified estate and gift tax rate is 40 percent with an inflation-adjusted $5 million exclusion for gifts made and estates of decedents dying after December 31, 2012. The gift tax exclusion allows taxpayers to give up to an inflation-adjusted $14,000 to any individual, gift-tax free and without counting the amount of the gift toward the lifetime $5 million exclusion, adjusted for inflation. The applicable **exclusion amount, as adjusted for inflation, is $5,430,000 for gifts made and estates of decedents dying in 2015**. There is no limit on the number of individual donees to whom gifts may be made under the $14,000 exclusion. Spouses may "split" their gifts to each donee, effectively raising the per donee annual maximum exclusion to $28,000. You can't, however, carry over unused exclusions from one year to the next. Spouses may give an unlimited amount of gifts to one another without any gift tax imposed.

LIFE CYCLE CHANGES IMPORTANT TO YEAR-END STRATEGIES

In addition to changes in the tax law, year-end tax strategies should also consider personal circumstances that changed during 2015 as well as what may change in 2016. These "life cycle" events include:

- Change in filing status: marriage, divorce, death or head of household changes
- Birth of a child
- Child no longer young enough for child credit
- Child who has outgrown the "kiddie" tax
- Casualty losses
- Changes in medical expenses
- Moving/relocation
- College and other tuition expenses
- Employment changes
- Retirement
- Personal bankruptcy
- Large inheritance
- Business successes or failures

YEAR-END INVESTMENT MOVES

Harvest Capital Losses

There are a number of year-end investment strategies that can help lower your tax bill. Perhaps the simplest is **reviewing your securities portfolio for any losers that can be sold before year-end to offset gains you have already recognized this year** or to get you to the $3,000 ($1,500 married filing separate) net capital loss that's deductible each year. Don't worry if your net loss for the year exceeds $3,000, because the excess carries over indefinitely to future tax years. Be mindful, however, of the wash sale rule when you jettison losers—your loss is deferred if you purchase substantially identical stock or securities within the period beginning 30 days before and ending 30 days after the sale date.

Consider a Bond Swap

Bond swaps can be an effective means of generating capital losses. With a bond swap, you start with a bond or bond fund that has decreased in value, which might be due to an increase in interest rates or a lowering of the issuer's creditworthiness. You sell the bond or fund shares and immediately reinvest in a similar (but not substantially identical) bond or bond fund. The end result is that you recognize a taxable loss and still hold a bond or shares in a bond fund that pays you similar or more interest than before.

Secure a Deduction for Nearly Worthless Securities

If you own any securities that are all but worthless with little hope of recovery, you might **consider selling them before the end of the year** so you can capitalize on the loss this year. You can deduct a loss on worthless securities only if you can prove the investment is completely worthless. Thus, a deduction is not available, as long as you own the security and it has any value at all. Total worthlessness can be very difficult to establish with any certainty. To avoid the issue, it may be easier just to sell the security if it has any marketable value. As long as the sale is not to a family member, this allows you to claim a loss for the difference between your tax basis and the proceeds (subject to the normal rules capital loss and wash sale rules previously discussed).

Conclusion

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you. We also will need to stay in close touch in the event that Congress revives expired tax breaks to assure that you don't miss out on any resuscitated tax-saving opportunities.

Very truly yours,

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