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Client Bulletin

Smart Tax, Business & Planning Ideas *from your* Trusted Business Advisor℠

April 2016

Special Report on the Protecting Americans from Tax Hikes Act of 2015

Last December, President Obama signed the Protecting Americans from Tax Hikes (PATH) Act of 2015 into law. The new law contains several tax benefits for individuals and companies.

What's more, PATH was not a simple "extenders" act, continuing certain tax breaks for a year or two. On the contrary, PATH converted many tax code provisions from temporary to permanent, retroactive to the beginning of 2015. Therefore, you can have much more confidence in future tax plans regarding these provisions. (Other tax code provisions that had expired, or were scheduled to expire, were extended for two or five years, retroactive to 2015.)

This issue of the CPA Client Bulletin covers some of the main tax rules that have been affected. If you have questions about these and other tax code items that were set to expire in 2015 or later years, contact our office for details. ■

Deducting Sales Taxes

Taxpayers who itemize deductions on Schedule A of IRS Form 1040 can deduct some state and local tax payments from their income. Among the formerly impermanent tax deductions that are now permanent is the option to deduct sales instead of income taxes.

Example: Marge and Nick Palmer always itemize deductions on their joint tax return. Generally, the Palmers deduct the state income tax they pay. In 2015, though, their income fell, and so did the state income tax they paid. The Palmers also have made some large purchases, paying steep amounts of sales tax. For 2015 and future years, the Palmers can deduct the sales tax they paid instead of the state income tax they paid, if the amount of sales tax exceeded their income tax.

continued on page 2

What's Inside

1 Deducting Sales Taxes

2 IRA Charitable Donations

2 Higher Education Tax Breaks

3 Tax-Free Investment Gains

3 Business Tax Benefits

4 Tax Calendar

Money Matters

In 2016, 56% of employers intend to bolster employees' financial well-being with educational initiatives that go beyond retirement planning to the basics of financial markets, budgeting, and debt management.

continued from page 1

This tax provision obviously helps people who live in a state with no income tax; other taxpayers also may benefit. A taxpayer may deduct the actual amount of sales taxes paid during the year or, alternatively, may use tables created by the IRS to determine the allowable deduction. If a taxpayer uses the tables to determine the deduction, he or she can add the tax paid on certain items (cars and boats, for example) to the amount from the IRS tables. ■

IRA Charitable Donations

For most people, using IRA dollars for charity is a two-step process. You take money from your IRA, reporting taxable income. Then, you donate it to the charity or charities of your choice, perhaps claiming a tax deduction for the contribution.

The new PATH law establishes the permanence of qualified charitable distributions (QCDs), which go directly from IRAs to recipient organizations. They're available only to IRA owners age 70½ or older. Such individuals can use QCDs every year now, up to $100,000 per year.

Once IRA owners reach age 70½, they usually must take certain amounts of required minimum distributions (RMDs) each year or pay a 50% penalty on any shortfall. QCDs count toward RMDs.

Example: Joyce Harris, age 72, has a 2016 RMD of $20,000. If Joyce, who gives $5,000 to charities each year, makes those donations directly from her IRA, that $5,000 counts toward her RMD for the year, so she'll only have to withdraw another $15,000 from her IRA in 2016. She'll report only $15,000 of taxable income, not $20,000, but she won't get a tax deduction for the $5,000 flowing from her IRA to charities.

Why would Joyce do this? There are several situations in which using a QCD could pay off. Perhaps most important, Joyce will be able to satisfy her $20,000 RMD obligation yet only report $15,000 of income, thus, reducing what otherwise would be her adjusted gross income (AGI) by $5,000. For some taxpayers, QCDs can eliminate any addition to AGI from their required IRA distributions. A lower AGI, in turn, can offer many benefits throughout your tax return. Our office can go over your specific situation to see if using an IRA for donations after age 70½ would be tax-effective for you. ■

Did You Know?

A law passed in 2015 will essentially end the "file and suspend" strategy for claiming Social Security benefits. Under this strategy, seniors can begin Social Security at full retirement age (now 66) but then suspend payments until age 70, allowing the payment amount to increase. During the suspension period, a spouse or eligible child can receive benefits based on that senior's work history. After April 30, 2016, the file and suspend option will no longer be available for the benefit of a spouse or child. However, taxpayers that have reached full retirement age before May 1, 2016, can still take advantage of the strategy if they submit a request to file and suspend by that date.

Source: bankrate.com

Higher Education Tax Breaks

In 2009, Congress replaced the Hope Scholarship Tax Credit with the American Opportunity Tax Credit (AOTC). Compared with the Hope credit, the AOTC offers more annual tax savings and is available to people with higher incomes. Moreover, the AOTC can be claimed during a student's first four years of higher education, whereas the Hope credit was limited to the first two years.

The AOTC was scheduled to expire after 2017, but the PATH Act makes it permanent. Under the AOTC, the maximum tax saving is $2,500 per student per year; that amount requires you to spend at least $4,000 per student in a calendar year. In addition, 40% of the AOTC (up to $1,000) is refundable, which means you can receive a check from the IRS if you owe no tax.

Money you pay for tuition and related fees counts for calculating the tax credit. Such qualified expenses also include expenditures for course materials, which means books, supplies and equipment needed for a course of study. An expenditure for a computer also would qualify for the credit if the computer is needed as a condition of enrollment or attendance at the educational institution.

To get the full AOTC, your modified adjusted gross income (MAGI) must be $80,000 or less, or $160,000 or less if you file a joint return. The credit phases out for taxpayers with MAGI over those amounts, with no credit allowed if your MAGI is over $90,000 or $180,000 if you file a joint return.

529 plans

These plans, offered by most states, allow contributions to grow, tax-free. Withdrawals also are untaxed to the extent of qualified higher education expenses.

Previously, computers and related equipment were considered "qualified," for this purpose, only if they were required by the school for course attendance or enrollment. Under the PATH Act, outlays for computers, peripheral equipment, Internet access and computer software are classed as qualified expenses, even if they are not specifically required. Thus, if you buy a computer or related items for college, you can take money from the student's 529 plan to cover the costs without owing any tax or penalty.

ABLE accounts

Another PATH provision affects ABLE accounts, sometimes known as 529A plans. ABLE accounts are for individuals with special needs; tax-free distributions allow beneficiaries to pay for disability-related expenses

without sacrificing government assistance benefits. Formerly, ABLE beneficiaries were limited to their home state's plan, but now any state's ABLE plan will be acceptable. ■

Tax-Free Investment Gains

For more than 20 years, Section 1202 of the tax code has offered benefits to investors in certain small companies. Generally, non-corporate investors can use this tax break if they buy stock in companies that met specified criteria. After a holding period of at least 5 years, any gain on a sale will be taxed favorably.

Originally, the tax exclusion applied to 50% of the gain. In 2010, the exclusion was temporarily increased to 100%, for purchases after September 27 of that year; the 100% exclusion was extended but expired after 2014. Now the 100% exclusion on the sale of qualified small business stock (QSBS) is permanent. Another temporary measure—exclusion of QSBS gain from the alternative minimum tax—also is permanent under the PATH Act.

Trusted Advice

Qualified Small Business Stock

Several requirements apply to the 100% tax exclusion on gains from selling small business stock. They include the following:

- You must acquire stock in a C corporation, originally issued after Sept 27, 2010.
- The corporation must have total gross assets of $50 million or less at all times after August 9, 1993, and before it issued the stock.
- The company's gross assets immediately after it issued the stock must have been no more than $50 million.
- During substantially all the time you hold the stock, the corporation meets the active business requirements (that is, the corporation is an eligible corporation that uses at least 80% [by value] of its assets in the active conduct of one or more qualified trades or businesses).
- With some specified exceptions, you must have acquired the stock at its original issue, directly or through an underwriter.

With the recent increase in capital gains tax rates for high-income taxpayers and the possible imposition of the 3.8% Medicare surtax, tax-free gains from a profitable investment may be appealing. ■

Business Tax Benefits

The tax code includes Section 179, which permits first-year deduction (expensing) of amounts spent for business equipment. This provision formerly allowed annual deductions up to $25,000. After $200,000 of equipment outlays, the allowance phased out, dollar-for-dollar.

Congress had raised these amounts sharply in recent years, but the increases expired periodically, going back to the original amounts. The latest expiration occurred at the end of 2014, so the smaller limit was officially in effect until passage of the PATH Act in late 2015.

Now, the higher Section 179 limits are permanent. For 2015, expensing up to $500,000 of equipment is allowed, and the phaseout doesn't begin until $2 million of purchases. Both the $500,000 and $2 million amounts will be indexed for inflation, starting in 2016.

continued on page 4

continued from page 3

Example 1: ABC Corp. spent $600,000 on equipment in 2015. The company can deduct $500,000, the permanent Section 179 cap, while the other $100,000 can be depreciated under other rules.

Example 2: XYZ Corp. spent $2,100,000 on equipment in 2015. That's $100,000 over the $2 million limit, so Section 179 expensing is reduced by that $100,000, from $500,000 to $400,000. If the company expenses $400,000, it can depreciate the remaining $1,700,000 under other rules.

The PATH Act includes off-the-shelf computer software as Section 179 property, which was not always the case.

Beyond expensing under Section 179, "bonus" depreciation has allowed additional first-year depreciation deductions for amounts spent on certain business equipment. That provision, which expired after 2014, has not been made permanent; instead, it was extended through 2019. For 2015 through 2017, 50% of the relevant cost may be deducted. That number will fall to 40% in 2018 and 30% in 2019.

R&D tax credit

The PATH Act also gave permanent status to the research & development tax credit (R&D credit), retroactive to 2015. This credit can be used by companies that increase their qualified research expenses. Qualified research expenses includes the costs of in-house qualified research and amounts paid to outside contractors for qualified research. If the credit can't be used currently, it can be carried forward or transferred in an acquisition.

Technology-based companies may be the main users of this tax credit, but firms in all fields may get some benefit. Tracking R&D costs to qualify for the credit can be complex, however. Our office can help your business set up the procedures to make the most of this tax break.

Cadillac health plans

As part of the Affordable Care Act, employer-provided health insurance deemed to provide excessive benefits will be subject to a special tax. This tax was supposed to take effect for tax years beginning after 2017, but the PATH Act postpones the start date for two years. This gives employers more time to evaluate their health plans and phase in any changes.

In addition, the new tax law provides that a company paying the so-called "Cadillac" plan tax will be able to deduct the amount paid from its income tax. Thus, the actual cost of the Cadillac plan tax may be reduced. ■

TAX CALENDAR

APRIL 2016

April 18

Individuals. File a 2015 income tax return. (If you are a resident of Massachusetts or Maine, Patriots' Day [April 18] delays the due date for filing your income tax return until April 19.) If you want an automatic six-month extension of time to file the return, file Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return. Then, file Form 1040, 1040A, or 1040EZ by October 17.

If you are not paying your 2016 income tax through withholding (or will not pay in enough tax during the year that way), pay the first installment of your 2016 estimated tax. Use Form 1040-ES.

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in March if the monthly rule applies.

Household employers. If you paid cash wages of $1,900 or more in 2015 to a household employee, file Schedule H (Form 1040) with your income tax return and report any household employment taxes. Report any federal unemployment (FUTA) tax on Schedule H if you paid total cash wages of $1,000 or more in any calendar quarter of 2014 or 2015 to household employees. Also report any income tax you withheld for your household employees.

Partnerships. File a 2015 calendar-year return (Form 1065). Provide each partner with a copy of Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc., or a substitute Schedule K-1. If you want an automatic five-month extension of time to file the return and provide Schedule K-1 or a substitute Schedule K-1, file Form 7004. Then, file Form 1065 by September 15.

Electing large partnerships. File a 2015 calendar-year return (Form 1065-B). If you want an automatic six-month extension of time to file the return, file Form 7004. Then, file Form 1065-B by October 17.

Corporations. Deposit the first installment of estimated income tax for 2016.

MAY 2016

May 10

Employers. For Social Security, Medicare, and withheld income tax, file Form 941 for the first quarter of 2016. This due date applies only if you deposited the tax for the quarter in full and on time.

May 16

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in April if the monthly rule applies.

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