M&D Watch

Tax

2016 Tax Planning Guidelines for Individuals & Businesses
2016 - Issue IV

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As prudent at this time of year, taxpayers look for ways to reduce their tax liability either through increased deductions or credits. Additionally, we look to the future opportunities relating to new policies as to be outlined by the incoming President and Republican controlled Congress. Businesses and individuals alike have many opportunities available to reduce their overall tax burden. While this may seem like a massive undertaking, the path ahead is not as intimidating as it may seem.

We have outlined a few planning strategies for consideration by businesses and business owners.

Business Planning:

Due to the passage of the PATH act in late 2015 (which permanently extended many tax incentives that were previously temporary and renewed annually), business tax planning for the 2016 year-end can be done with somewhat more clarity than in past years, given the certainty of availability of various deductions and credits. However, taxpayers will need to consider the potential tax law changes which could occur as the tax policy of the new administration is implemented.

Businesses seeking to maximize tax benefits through 2016 year-end tax planning may want to consider two general strategies: (1) Use of traditional timing techniques for income and deductions, such as income deferral and deduction acceleration, (or potentially income deferral and deduction acceleration if corporations are planning for the expected reduction in tax rates discussed above) and (2) Special consideration of significant tax incentives (including those which may increase or be eliminated next year). These include the IRS Section 179 deduction (with a limit of $500,000 that may be increased to $1,000,000 in future years), research tax credits and bonus depreciation.

Businesses may want to consider the following key items in order to effectively engage in tax planning for year-end:

1. Costs related to tangible property may provide for significant tax planning opportunities. Acquisitions of certain items of property under $5,000 can be deducted under a de minimis safe-harbor provision, if the taxpayer issues audited financial statements. In the event that audited financial statements are not issued, the limit is decreased to $2,500. Taxpayers must have a written policy in place to qualify.

2. The IRS has provided qualified retail and restaurant businesses with a safe-harbor method for determining whether expenses paid or incurred to remodel or refresh a qualified building are deductible, capitalized as

improvements, or capitalized as the costs of property produced by the taxpayer for use in its trade or business. If the safe harbor applies, 25 percent of qualifying remodel-refresh costs are capitalized and the remaining costs are currently deductible. The safe harbor method may not be used unless the taxpayer places the building in a MACRS general asset account.

3. For tax year 2016, bonus depreciation can be deducted for up to 50 percent of the cost of the asset (this election will remain at the 50 percent level for 2017 under current law and decrease thereafter through 2019). Although a final decision on making the bonus depreciation deduction is not required until a return is filed, taxpayers should consider the impact of such an election on their taxable income for 2016, especially in planning asset acquisitions prior to year-end. Taxpayers may consider electing out to spread depreciation deductions more evenly over future periods and/or remain consistent with the state depreciation deduction for those states which have decoupled from bonus depreciation (many states such as New York, New Jersey and Pennsylvania have decoupled).

4. The amount permitted to be expensed under Internal Revenue Code Section 179 for new and used eligible business property purchased during 2016 is $500,000, with an investment limit at $2,010,000 before phase-out. This amount will definitely increase for inflation in 2017 and potentially double. Taxpayers should take advantage of this annual deduction.

5. The research and development credit may be claimed for increases in business-related qualified research expenditures and for increases in payments to universities and other qualified organizations for basic research.

6. New rules under Section 385 would treat certain related-party debt as stock, rather than debt, for federal tax purposes, if extensive documentation requirements with respect to such debt instruments are not met.

7. The five year period for recognizing built-in gains tax for S corporations is now permanent, so taxpayers who wish to plan around conversion to/from an S corporation can now do so with more certainty.

8. Domestic manufacturing and certain other production activities may qualify for a tax deduction under IRC Section 199 which allows taxpayers to deduct 9% of the lesser of qualified production activity income or taxable income for the year, limited to 50% of qualifying wages. Historically, this has been underutilized. Taxpayers should look to take advantage of the deduction as it applies to their particular tax situation. This deduction may be eliminated once the tax policy of the new administration is implemented.

9. Under the Affordable Care Act, Employers with 50 or more full-time employees are required to file Forms 1094-C and 1095-C, Employer-Provided Health Insurance Offer and Coverage with both the employee and the IRS. This Form includes information about whether the employer offered qualifying health coverage to the employee, spouse and dependents for some or all months during the year. The penalties for non-filing are $100-$250 per form.

10. Effective for tax years beginning after December 31, 2017, adjustments made in an IRS examination of a partnership are assessed against the partnership itself in the year of examination. This shifts the burden of examination adjustments from the partners during the tax year under examination to the partners in the year the examination ends. Planning can be done to implement these provisions early and/or adjust partnership agreements to mitigate the impact of complying with these rules.

11. Cash basis taxpayers should analyze whether they can pre-pay expenses and accelerate deductions. Accrual basis taxpayers should review their accounts receivable for possible bad debt deductions and dispose of unsalable inventory.

12. Due dates for extensions and final payments of tax will change for 2016 (April 15th for corporations and March 15th for partnerships) and planning should be done to ensure compliance with these due dates.

13. NOL and credit utilization should be considered in determining whether to accelerate income and/or deduction recognition. If such attributes are expiring, acceleration of income may be an appropriate course of action despite the anticipation of reduced corporate income tax rates.

14. Cross-border transactions and the application of the transfer pricing rules to such transactions should be considered, especially in light of the additional scrutiny such transactions are subject to due to the impact of BEPS.

Individual Income Tax Planning

1. *Capital gains and losses*
   a. *Netting of capital gains and losses*: Taxpayers are allowed to deduct up to $3,000 of net capital losses against ordinary income. Excess capital losses are carried over to future tax years. Review your capital loss carryovers to determine if any appreciated positions could be sold without incurring additional income tax.
   b. *Harvest tax losses:* If you have overall net capital gains, consider selling loss positions. Securities sold at a loss could be repurchased subject to the wash sale rule. This rule prohibits you from recognizing losses if you purchase substantially identical securities within 30 days before or after the sale. Consider purchasing Exchange Traded Funds tied to the original securities industry or sector to avoid waiting the 30 days.
   c. *Qualified small business stock:* Taxpayers who acquire stock that is qualified small business stock and hold the stock for five years may exclude up to 100% of the gain from income upon the sale of the stock. The exclusion is generally 50%, but was increased to 75% for QSBS acquired after February 17, 2009, and before September 28, 2010; and to 100% for QSBS acquired after September 27, 2010, and before January 1, 2015. For QSBS acquired after January 1, 2015, the exclusion returned to 50%. QSBS gain is generally treated as a preference item for AMT purposes, except QSBS gain that qualifies for the 100% exclusion, which is not treated as an AMT preference item.

2. *Alternative minimum tax (AMT):* AMT is a parallel tax system that was originally intended to cause wealthy taxpayers to pay their fair share of tax. Over the years, more and more individuals (many of whom would not consider themselves wealthy) have become subject to this tax. The AMT system disallows or limits many common income tax deductions including the deduction for state and local income taxes, real estate taxes, interest on home equity loans not used to build or improve your residence, and miscellaneous itemized deductions such as investment advisory fees. AMT brackets and exemptions are indexed annually for inflation. When timing income and deductions, taxpayers must carefully analyze their AMT situation.

a. If you project that you will be subject to AMT in 2016, you should consider deferring certain deductions such as state income tax payments and real estate taxes until 2017 if you do not expect to be subject to AMT in 2017.

b. If you project that you will be subject to AMT in 2016, you should consider accelerating ordinary income into 2016. You would pay your tax sooner, but the income may be taxed at 28% (the highest AMT rate) as opposed to 39.6% (the highest ordinary income tax rate)

    c. If you are not projected to be subject to AMT in 2016, you should consider paying your fourth quarter state estimated tax payment prior to December 31, 2016 instead of waiting until its actual due date of January 15, 2017.

    d. If you are not projected to be subject to AMT in 2016, also consider exercising Incentive Stock Options (ISOs).

3. *Retirement Planning*

SEP-IRAs: Self-employed individuals can take advantage of contributions to retirement plans to improve their tax standing. An individual with a SEP-IRA may be eligible to make a contribution of up to the lower of $53,000 ($54,000 in 2017) or 20% of net self-employment income. This can offset the ordinary income earned during the year, which will eventually lower the overall tax bite. Self-employed individuals can also establish other types of plans such as a Keogh Plan and defined benefit plans.

4. *Miscellaneous Items:*

a. Consider accelerating or deferring income such as salaries or bonuses to take advantage of income tax brackets.

b. Medical expenses are deductible only if they exceed 10% of your AGI. The threshold is 7.5% of AGI for any tax year beginning before January 1, 2017 for taxpayers who have attained age 65 before the close of such year. Consider bunching medical expenses into one year in order to reach these floors.

c. Charitable contributions can provide personal satisfaction along with potentially large income tax deductions. Charitable contribution planning is also completely discretionary and can be timed to best meet your needs. Contributions of cash to public charities can be deducted up to 50% of your AGI and contributions of appreciated property held for over one year can generally be deducted up to 30% of AGI. As mentioned above, President-elect Trump has proposed capping itemized deductions at $200,000 for married filing joint taxpayers ($100,000 for single taxpayers). If this proposal is enacted into law, the deductibility of one's charitable contributions could be limited. Consequently, if one has outstanding pledges or is considering making sizable charitable contributions, one should consider accelerating the payment into the 2016 tax year.

d. You should review your income tax withholdings and estimated tax payments already made to determine if you have paid enough already to avoid the underpayment of estimated tax penalty. If not, request that your employer take out additional withholdings and/or make a fourth quarter estimated tax payment. Income tax withholdings are considered withheld pro rata throughout the year, so if there is a shortfall during one of the previous quarters, additional withholdings at this time can help avoid or minimize the underpayment of estimated tax penalty. When determining your estimated tax liability for 2016, remember to include the additional .9% Medicare tax as well as the 3.8% net investment income tax.

Future opportunities

President-elect Donald Trump ran on the platform of "making America great again". One of his key drivers in doing that is to bring jobs, particularly manufacturing jobs, back to the US. One of his goals to accomplish this is to simplify the tax code; he is also looking to make sizable changes to tax rates and the overall tax landscape. The GOP has also issued its blueprint for tax reform. Some of the proposals can be found below.

From an individual standpoint:

- Reduce the number of tax brackets from eight to three. The highest tax bracket would be 33% and would begin at $225,000 for Married Filing Joint filers and $112,500 for a Single filer.
- Eliminate the Net Investment Income Tax as well as the Alternative Minimum Tax.
- The Standard Deduction would increase to $15,000 for Single filers and $30,000 for Married Filing Joint filers.
- Passthrough income may be taxed at a flat 15 percent rate, to the extent that the income is retained within the business.
- The personal exemption would be eliminated as would the Head of Household filing status.
- Carried interest would be taxed as ordinary income tax rates.
- Itemized deductions would be capped at $100,000 for single filers and $200,000 for Married Filing Joint.
- Based on the average cost of care in the resident state, childcare costs will be deductible against Adjusted Gross Income. These costs will be eliminated for income greater than $500,000 for Married Filing Joint and $225,000 for Single filers.
- Eliminate the "death" tax and include some form of capital gains tax at death or when a decedent's assets are sold.

From a business standpoint:

- The corporate tax rate will be reduced to 15% from 35%.
- Similar to individuals, the corporate Alternative Minimum Tax will be eliminated.
- Allows firms engaged in manufacturing in the United States to choose between expensing of capital investment and the deductibility of interest paid.
- The Section 179 expense maximum will be increased from $500,000 to $1,000,000.
- The GOP's blueprint will eliminate the Domestic Production Activities Deduction (DPAD) under Internal Revenue Code Section 199 and all other business credits, except for the Research and Development credit.
- Deemed repatriation of currently deferred foreign profits, at a tax rate of 10 percent.
- Increases the cap for the tax credit for employer-provided day care under Section 205 of the EGTRA from 2011 from $150,000 to $500,000 and reduces its recapture from 10 years to 5.

To learn more about any of the strategies mentioned, or to discuss your circumstances, please contact your WeiserMazars tax professional for more information.

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