As the end of the year approaches, it is time to consider planning opportunities that could help lower your tax bill for this year and possibly the next. Factors that compound this challenge include turbulence in the stock market, overall economic uncertainty, and Congress’s failure to act on a number of important tax breaks that expired at the end of 2015. Some of these tax breaks ultimately may be retroactively reinstated and extended, as they were last year, but Congress may not decide the fate of these tax breaks until the very end of 2015 (or later).

Executive Summary

In this article we will expand on the following year-end planning tips:

- Minimize taxable income in order to ensure that your tax breaks are not reduced or eliminated due to phase-outs.
- Consider the timing of controllable income that can be deferred and deductions that can be accelerated. Take advantage of any available expensing and accelerated depreciation deductions.
- Gift appreciated property at year-end to shift taxable gain to lower-bracket family members while taking advantage of the annual gift tax exclusion.
- Use appreciated assets to meet your charitable giving intentions and obligations.
- Make the best use of your tax losses.
- Dispose of passive activities in order to use suspended passive losses.
- Increase the withholding on wages in order to prevent an estimated tax underpayment penalty.
- Review your year-to-date contributions to your retirement plans and/or 401(k) and consider increasing the amounts before year end.
- Consider a conversion from a traditional IRA to a Roth IRA. If you converted earlier in the year and asset values have declined, consider reversing the conversion in order to avoid paying taxes on the higher value.

Congressional Environment — Tax Break Extensions

The “Tax Relief Extension Act of 2015” bill was introduced into Congress on August 5, 2015 and, if approved in the current form, will provide the following tax break extensions for 2015 and 2016:

INDIVIDUAL TAX EXTENDERS

- Tax-free distributions from individual retirement plans for charitable purposes
- Option to deduct state and local sales taxes
- Deductions for mortgage insurance premiums
- Deduction for qualified tuition and related expenses

BUSINESS TAX EXTENDERS

- Research & Development credit
- Increased limitation of $500,000 for expensing Section 179 property
- 50% bonus depreciation
- 15-year straight-line cost recovery for qualified leasehold, restaurant, and retail improvements
- 100% exclusion for qualified small business stock
Higher-Earning Individuals

Higher-income earners have unique concerns to address when mapping out year-end plans. They must be wary of the 3.8% Net Investment Income Tax (NIIT) on investment and passive income and the additional 0.9% Medicare tax on wages.

The NIIT applies to the lesser of: (1) net investment income (interest, dividends, capital gains, passive income/loss), or (2) the excess of adjusted gross income over $250,000 for joint filers and $200,000 for individuals.

The Medicare tax applies to individuals for whom the sum of their wages and their self-employment income is in excess of $250,000 for joint filers and $200,000 for individuals.

Keep in mind that deferment of investment income or wages/self employment income can reduce these taxes. In addition, the acceleration of state income tax payments can help to reduce income subject to NIIT.

Affordable Health Care Act Considerations — Businesses

Under the Affordable Care Act’s employer shared responsibility provisions, certain employers (called applicable large employers or ALEs) must offer minimum essential coverage that is “affordable” and that provides “minimum value” to their full-time employees (and their dependents). If you employed 50 or more full-time employees and full-time equivalents (FTEs), you are considered an ALE. To determine ALE status, you first need to count all full-time employees that work over 30 hours per week and then add to it all part-time employees hours and divided by 120 per month to determine your number of FTEs.

For 2015, there are significant penalties for ALEs that have 100 or more full-time plus FTEs and do not provide minimum essential coverage. These penalties are postponed until 2016 for employers with 50-99 full-time and FTEs.

In addition, ALEs with 50 or more employees are subject to year-end employee and employer filing requirements for 2015. Forms 1094-C and 1095-C must be completed. These forms report the health coverage offered and employee enrollment in the coverage. Employees must receive copies of forms 1095-C by February 1, 2016. The forms 1094-C and 1095-C must be filed with the IRS by February 29, 2016 if filing by paper or March 31, 2016 if filing electronically. There are penalties up to $500 per return for failing to timely file the returns and/or furnish the forms to employees.

Determine whether you are likely to be subject to the Alternative Minimum Tax (AMT) and if the actions you are considering will trigger it. Many deductions used to calculate regular tax are disallowed for AMT purposes, some of which include the deductions for state income taxes, real estate taxes, miscellaneous itemized deductions, and personal exemption deductions. Do not accelerate these deductions when you are subject to the AMT or suspect you might be.

If possible, it may be beneficial to have your employer defer a year-end bonus until 2016.
Take losses on stocks and mutual funds in order to offset any taxable gains realized during the year. However, annual deductible capital losses are limited to $3,000 in excess of your gains. Any unused loss can be carried over to future years.

In order to reduce 2015 taxable income, consider disposing of a passive activity if you have suspended passive activity losses.

If you plan to make charitable donations, consider donating appreciated capital gain assets (such as stocks) rather than cash. By doing so, you avoid the capital gain tax and 3.8% net investment income tax.

Consider using a credit card to pay for charitable contributions before year end. Even if you don’t pay your credit card bill until 2016, you will still receive the deduction in 2015. Don’t forget to document your out-of-pocket expenses included when volunteering for a charity.

If you expect to owe state income taxes, consider paying your fourth-quarter estimated state income tax payment, as well as your real estate property taxes in December 2015. You can also ask your employer to increase your 2015 state tax withholding, unless you are likely to be subject to AMT.

It may be beneficial to bunch in the current year or next year, your miscellaneous itemized deductions, which are allowed only to the extent they exceed 2% of adjusted gross income, as well as medical expenses, which are taken only in excess of 10% of your adjusted gross income.

Maximize your contributions to retirement plans and 401(k) plans. When you have a business, contributions to the business’s plan may reduce your taxable income.

If you currently have a traditional IRA, you may benefit from converting to a Roth IRA, which will allow you to transform a tax-deferred future growth into tax-free growth.

• You will pay taxes on the IRA asset value converted to a Roth, but the assets will continue to grow tax-free and can later be withdrawn tax-free.

• Converting your IRA to a Roth IRA is more desirable if your current IRA balance includes significant non-deductible IRA contributions, since these amounts will reduce the taxable portion of the conversion.

• Be aware that the income from the conversion will raise your AGI, and may trigger NIIT, Additional Medicare tax, or itemized deduction phase-outs.

If you have converted assets from a traditional IRA to a Roth IRA earlier this year and the assets in the Roth IRA account declined in value, you will end up paying higher taxes than needed. In this case, you can choose to reverse the transaction by transferring the converted amount from the Roth IRA back to a traditional IRA using a trustee-to-trustee transfer. You can then choose to re-convert the IRA to a Roth IRA at the current, lower market value.

• Roth conversions are not appropriate for everyone, and you should consult your tax advisor before taking action on a conversion.

When you reach the age of 70½, you must take required minimum distributions (RMDs) from your IRA, 401(k) plan, and other qualified retirement plans. If you turned 70½ this year, you should consider delaying the first required distribution to 2016, and hence, defer the income for one more year. This will benefit many but not everyone depending on their income situation in 2015 and 2016.

If you are eligible to make contributions to your Health Savings Account (HSA) you can still maximize your 2015 contribution before year end so you will have a full year’s worth of deductible HSA contributions. If you do not have an HSA and your insurance plan allows for one, consider establishing and contributing to the account before year-end.

For 2016, increase the amount in your employer-sponsored Flexible Spending Account (FSA) if you set aside too little for this year.

Consider making a $14,000 ($28,000, if married) gift to family members before the end of year. This will not only reduce the estate taxes ultimately paid, but will also reduce income taxes on the earnings of that money. The benefits are multiplied if the gifts are those of appreciated property.

Tuition and medical expenses paid on someone’s behalf are free of gift tax and also does not count against the annual gift exclusion. The payments must be paid directly to the school and medical care expenses directly to the healthcare provider. You may want to consider a plan to systematically pay these expenses for certain family members.

Avoid potential penalties related to foreign asset reporting by gathering necessary tax records.
Moving into a higher tax bracket next year can potentially be avoided by accelerating income from 2016 to 2015. On the other hand, income should be deferred until 2016 if moving into a higher bracket this year can be prevented.

While the election to deduct business property under Sec. 179 has been greatly reduced for 2015 (unless Congress opts to change this option), you can still deduct the cost of qualified fixed asset expenditures up to $25,000.

Businesses should consider the “de minimis safe harbor election” to expense the costs of lower value capital assets, materials and supplies. Regulations allow businesses to write off small asset purchases. The amount that can be written off is up to $5,000 per item or invoice if you have an audited financial statement and $2,500 per item for 2016 ($500 for 2015) if you do not. To take advantage of this provision, you must follow that policy not only for tax purposes but also for financial statement purposes. In addition, if you issue audited financial statements, your capitalization policy must be in writing.

If a business purchases machinery and equipment before year-end, it could secure a half-year’s worth of depreciation deductions under the half-year convention. This works unless 40% or more of the total depreciable assets purchased are purchased in the last 3 months of the year.

Consider an assessment of your company’s retirement plans to determine if a change in plans could allow you to contribute more toward your retirement and provide additional tax deductions. If there is an older owner – employee, a defined benefit plan or cash balance plan could allow you to quickly build a substantial retirement fund.

There is a tax credit available equal to 50% of the health insurance premiums paid for employers who purchase their insurance through the SHOP (Small Business Health Options Program) Marketplace. To be eligible the employer must pay at least half of the employee’s premiums. The business must have less than 25 full-time equivalent employees with average wages of less than $50,000.

A C corporation that anticipates a small net operating loss (NOL) in 2015 and significant net income in 2016 should consider accelerating some of its 2016 income or deferring some of its 2015 deductions in order to produce a small amount of net income for 2015. This will allow it to base its 2016 estimated tax installments on the smaller amount of income shown on its 2015 return, instead of paying estimated taxes on 100% of its much larger 2016 taxable income.

Determine if you should increase your basis in a partnership or S corporation so that you can deduct current-year losses by loaning or contribution additional capital to the business.

If you have any additional questions about year-end tax planning, or if you need further assistance, please do not hesitate to contact us.

Judy Mason, CPA, CVA, has over 20 years of tax, accounting, business consulting, and compliance experience, serving closely-held and start-up businesses, entrepreneurial and family-owned companies, their owners and families. Her expertise is in federal, state, local, and employment taxation, guiding clients through the complexities of conducting business in a dynamic tax environment. She has successfully defended a broad range of federal income, state income, and sales tax audits for her clients. Juan Hernandez, a Senior Tax Accountant, also assisted with the creation of this article.

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