Quarterly Newsletter
November 2015

INSIGHTS

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Siegfried & Luke, Inc.

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UPCOMING DEADLINES

December 15
- Due date for 4th quarter estimated tax payments for corporations

January 15
- Due date for 4th quarter estimated tax payments for individuals, trusts, & estates

January 31
- Due date 2015 4th quarter and annual payroll tax fillings

Individual Year-End Tax Planning

As the end of the year approaches, it is time to look forward to tax issues that will have an effect on future tax filings, especially those that affect 2015 tax returns. Although Congress has passed only minimal tax legislation, here are the main things to be aware of going forward:

Net Investment Income (NII)

This 3.8% NII tax is calculated on net investment income in excess of modified gross adjustment income (MAGI), which includes capital gains, dividends, income from businesses in which the taxpayer is a passive participant, and rental income unless the taxpayer is a real estate professional.

The threshold amount is $250,000 for joint returns or a surviving spouse, $125,000 for married filing separate, and $200,000 in all other cases. Although each individual's situation will be unique, here are some ideas to keep income below the thresholds:

- Purchase municipal bonds and other tax-favored assets that will be excluded from MAGI and NII.
- Monitor income and capital gains, and elect out of installment sale treatment and excessive stock options.
- Reconsider distributions from trusts. Taxable trusts with distributable income in excess of $12,300 are subject to the NII tax, so consider making distributions to beneficiaries who would not be subject to the surtax.
- Likewise, consider giving long-term capital gain investments to family members who are not subject to NII. Tax-free Roth IRA distributions are not considered to be part of your MAGI, so individuals who can pay the taxes related to the conversion should consider Roth conversions.
- Increase contributions in qualified retirement plans and IRA accounts.

Alternative Minimum Tax (AMT)

The AMT exemption amounts are $53,600 for single individuals and head of households, $83,400 for married filing joint, and $41,700 for married filing separate. Some strategies for managing AMT include the following:

- Reduce exposure to AMT bonds that have tax-exempt interest, which is considered taxable income.
- Delay realizing large capital gains.
- Avoid exercising incentive stock options (ISOs) in the year a taxpayer is subject to AMT.

Pease limitations & PEP

Pease limitations reduce the total amount of itemized deductions by 3% for taxpayers with adjusted gross income thresholds of $309,900 for married couples and surviving spouses, $154,950 for married filing separately, $284,050 for heads of households, and $258,250 for unmarried taxpayers. Certain items, such as medical expenses, investment interest, and casualty, theft or wagering losses are excluded from this and the amount of itemized deductions is not reduced by more than 80%.

The personal exemption phase-out (PEP) threshold amounts are the same as the Pease limitations, and the total amount of exemptions that can be claimed is reduced by 2% for each $2,500 for married and 2% for each $1,250 for married filing separately of the taxpayer's adjusted gross income that exceeds the threshold amounts.

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Gift and estate tax

Gift and estate tax exclusions are now permanent, unified, and adjusted for inflation. For 2015, the amount an individual can transfer without the transfer tax is $5.43 million and the highest estate and gift tax rate is 40%.

Portability of the exclusion amount is available for a surviving spouse who wants to use the remaining unused amount of a deceased spouse.

An individual can give $14,000 to as many people as desired without it being included in the $5.43 million exclusion.

Giving Appreciated Stock to Charity

Taxpayers who want to give a charitable contribution may be able to save taxes when choosing to gift appreciated stocks. The benefits are that capital gains on the stock will be avoided since the stock is donated rather than sold, and the taxpayer is also eligible, in general, to receive a deduction for the full fair market value of the stock at the time the gift is made, or up to 30% of the taxpayer's adjusted gross income.

In order to take advantage of this, the security must have been held for at least one year, it must have a current value that is greater than the original cost, and the gift must be given by December 31st of the year that the charitable deduction is to be taken.

Healthcare

The Affordable Care Act (ACA) health insurance requirement is an issue that continues to change. For 2015, the penalty for failing to maintain qualifying health insurance is the greater of $325 per adult and $162.50 per child, not to exceed $975 or 2% of household income minus the amount of tax-filling threshold. For 2016, the penalty increases to $695 per adult and $347.50 per child or 2.5% of income above the tax-filing threshold.

Annual health flexible spending account (FSA) contributions limit increased to $2,550. The IRS changed the "use it or lose it" policy so that an employer can choose to allow employees to carry over up to $500 of unused funds in a health FSA account. Employees whose employer does not offer the carryover have an extension period of 2½ months to use remaining FSA funds before losing them. Taxpayers who have a high deductible heath plan (HDHP) have increased contribution limits of $3,350 for individuals and $4,450 for a family.

Retirement

401(k), 403(b), 457, SEP: Taxpayers contributions to these retirement plans remain topped out at $18,000 with an additional catch-up contribution for employees aged 50+ of up to $6,000.

SIMPLE IRA: Taxpayers may contribute up to $12,500, and those aged 50+ can contribute a total of $15,500.

Traditional/Roth IRA: The IRA contribution limit remains $5,500 with an additional $1,000 catch-up contribution for those aged 50+. However, as of 2015, taxpayers can only make one IRA-to-IRA rollover per year and any more than one rollover will be treated and taxed as a withdrawal, with up to 10% penalty for an early withdrawal.

Those turning 70.5 must begin taking annual required minimum distributions from retirement accounts or suffer a 50% penalty on the amount that should have been withdrawn.

Year-end tax planning requires a different approach for every taxpayer. If you have any questions, please do not hesitate to call. We would be happy to meet with you at your convenience to discuss the strategies outlined in this newsletter. While we are getting very close to the end of the year, there is still time to implement these strategies to minimize your 2015 tax liability. ■

Home Healthcare Medical Deduction

The United States Tax Court has ruled in the case *Estate of Baral v. Commissioner* (137 T.C. No. 1) that payments made to non-professional caregivers are tax deductible medical expenses. In the case, payments totaled $49,580 which were a significant deduction for the taxpayer.

These expenses fall under the Internal Revenue Code section 7702B(c) which states that qualified long-term care services include diagnostic, preventive, curing, treating, therapeutic, mitigating, and rehabilitative services, and maintenance or personal care services. The services must be required by a chronically ill individual and be part of a plan of care that is prescribed by a licensed health care practitioner.

The term 'chronically ill' describes any person who has been certified by a licensed health care practitioner as being unable to perform at least two activities of daily living for a period of at least ninety days. These activities include eating, toileting, transferring, bathing, dressing, and continence.

These expenses can be deducted for any chronically ill person who requires long-term care, regardless of age. However, it is important to note that these payments are NOT deductible if the caregivers are relatives of the chronically ill person.

Expiring & Extended Tax Provisions

To Be or Not to Be? The following tax provisions expired at the end of 2014 but are under consideration for extension before the end of the year:

Individuals

- State and local sales tax deductions.
- Exclusion of cancellation of mortgage debt of up to $2 million on a qualified principle residence.
- Higher education tuition and fees deduction with a maximum of $4,000 for qualified expenses.
- Mortgage insurance premiums being treated as qualified residence interest.
- Code Section 25C Credit, a credit available for energy efficient improvements to buildings.
- Contributions of capital gain real property for conservation purposes being allowed to be taken against 50% of an individual's charitable contribution base.
- Educators' classroom expense deduction of up to $250 for qualified expenses.
- Tax-free distributions of up to $100,000 from an IRA account to a charity for taxpayers over the age of 70½.

Businesses

- Code Section 179 expensing and bonus depreciation of property purchased for a trade or business. In prior years, up to $500,000 of business expenses could be written off and would not reduce the amount unless expenditures exceeded $2 million. Without this, the numbers are $25,000 and $200,000, respectively.
- Section 168(k) bonus depreciation, which provides a depreciation deduction equal to 50% of the adjusted basis of qualifying in the 1st year it is placed in service.
- Section 168(k)(4) which allows corporations to elect to accelerate AMT credit in lieu of bonus depreciation.
- Section 1367(d)(7) which allows S-corp shareholders to adjust their basis in stock when the S-corp makes charitable contributions of property using their basis in the property instead of its fair market value.

Employee versus Independent Contractor

The end of the year is a good time to review the status of those who are doing work for you or your business to determine if the individual will be classified as an employee or an independent contractor for next year. While there are multiple reasons for reconsideration, recent events make this even more important this year.

The enactment of the Affordable Care Act requires the calculation of FTE's, or full time equivalents, in order to determine how the Act applies, and the U.S. Labor Department published a 15-page memo of guidance in July of this year in order to clear up the definition of employee under the Fair Labor Standards Act.

Additionally, the U.S. Department of Labor recently awarded 19 states over $10 million to assist in the identification of employers culpable of misclassification, and the penalties for failure to file the necessary information returns reporting payments to independent contractors has increased. As a result, it is likely that this will be on the forefront of review by the IRS for the foreseeable future.

The Fair Labor Standards Act relies on the so-called "economic realities" test to guide the determination. The basics of this test provide for various questions:

- Is the work an integral part of the employer's business?
- Does the worker's managerial skill affect the worker's opportunity for profit or loss?
- How does the worker's relative investment compare to the employer's investment?
- Does the work performed require special skill and initiative?
- Is the relationship between the worker and the employer permanent or indefinite?
- What is the nature and degree of the employer's control?

The IRS has published Revenue Ruling 87-41 listing twenty factors for determining if control exists and will treat each case based on a facts and circumstances basis to determine the weight of each factor.

In review, the Courts have generally focused on the following seven factors:

- Who exercises control over details of the work done;
- Who invests in the tools and facilities used to do the work;
- Does the worker have the ability to generate a profit or loss;
- Can the worker be discharged by the principal;
- Is the worker part of the principal's regular business;
- Is the relationship permanent; and
- What relationship did the principal and worker intend to create?

While these questions appear simple, they should be thoroughly considered to arrive at the status determination. Each question should be given full weight and used as a guide to answer the ultimate question of economic dependence or independence of the worker from the employer. Once decided, great care should be taken to ensure that all wage and payment reporting rules are followed to comply with remittance of related payroll taxes and pay reporting forms due to steep penalties involved with noncompliance. ■

2016 Retirement Plan Contributions

On October 21, 2015, the IRS announced the various adjustments applicable to retirement plan contribution limits for 2016. All of the limits remain unchanged from 2015. These charts serve as a reminder of the contribution limits for 2016:

401k Plan Limits for 2016	
401k Elective Deferrals	$18,000
Annual Defined Contribution Limit	$53,000
Annual Compensation Limit	$265,000
Catch-up Contribution Limit	$6,000
Highly Compensated Employees	$120,000

Non-401k Related Items	
403(b)/457 Elective Deferrals	$18,000
SIMPLE Employee Deferrals	$12,500
SIMPLE Catch-up Deferral	$3,000
SEP Minimum Compensation	$600
SEP Annual Compensation Limit	$265,000
Social Security Wage Base	$118,500

Limitations that did change in 2016 are the following:

- The phase-out for the deduction of an IRA contributor who is not covered by a workplace retirement plan and is married to a partner who is increased to between $184,000 and $194,000 (previously between $183,000 and $193,000).
- The AGI phase-out range for taxpayers making contributions to a Roth IRA is increased by the same amount. Married filing joint phases out $184,000 to $194,000, and for singles and heads of household, the phase out range is $117,000 to $132,000.
- The AGI limit for the saver's credit (also known as the retirement savings contribution credit) for low-income and moderate-income workers is up to $61, 500 for married filing, up to $46,125 for heads of household, and $30,750 for married filing separately and single filers. ■

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Every taxpayer's situation is different and requires careful review and analysis.

If you have any questions about any item covered in this newsletter or items that you have heard about but were not covered, please contact our office to schedule a time to discuss your questions in greater detail.

Please contact Siegfried & Luke, Inc. with any questions.