Client advisor

CURRENT INFORMATION, NEWS AND TRENDS

SUMMER 2016 Volume XX, Number 1

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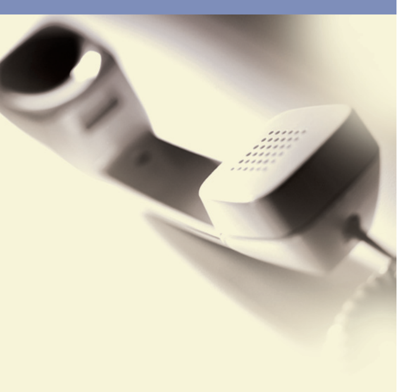


Was Your No-Health-Insurance Penalty A Surprise?

A tweet from a taxpayer, including a picture of the IRS notice he received advising him that he owes over $2,000 as a penalty on his 2014 tax return for not having health insurance, has gone viral and ignited a firestorm.

He stated in his post that he didn't buy health insurance because his premiums jumped by over $1,000 to $1,400 per month. Of course the increase in his insurance premiums were most likely due to the mandatory provisions included in the health plan that were needed to meet the minimum essential coverage requirements of the Affordable Care Act (ACA).

Like many uninsured taxpayers, he probably didn't fully read the penalty provisions or didn't fully grasp them, which is understandable since they were written by attorneys. What he, and probably thousands of other taxpayers, overlooked when making the decision whether to buy insurance was the fact the penalty was the HIGHER of two computations, the flat dollar amount and the percentage of income amount. The flat dollar amount for 2014 was $95 per adult and $47.50 for a child, with a maximum of $285 per family. This is where lots of people stopped reading and erroneously concluded that the penalty wouldn't be so bad when compared to the high premiums they were quoted, especially if they were relatively healthy and didn't feel a great need for insurance coverage. These taxpayers failed to consider the percentage of income penalty amount, which for 2014 was 1% of the taxpayer's household income after deducting his filing threshold (the sum of the filer's standard deduction and exemption amount for the filer and spouse, if any). Obviously his income was in excess of $200,000 since the 1% penalty totaled over $2,000.

If his penalty had been for 2016, he would be looking at a penalty 2.5 times the 2014 amount, over $6,000. Even for lower income individuals, the 2016 penalty can be as high as $2,085 for a family of four.

So if you are considering skipping health insurance coverage and paying the penalty, please consider the substantially higher penalty rates for 2016 and subsequent years.

Big Business Write-Offs Available

With the enactment of the Protecting Americans from Tax Hikes (PATH) Act, Congress made two significant business-friendly changes in the tax law, extending bonus depreciation and making the Section 179 deduction's higher expensing amount permanent. This article examines these changes so that you can take full advantage of them in your trade or business.

Section 179 Deduction – This provision allows a business owner or entity to immediately expense, rather than capitalize (depreciate), the cost of new or used tangible property – both personal property and certain real property – placed in service during the tax year. The maximum amount is adjusted annually for inflation and is $500,000 for 2016. However, based on Code Section 179, the maximum amount is reduced dollar-for-dollar by the cost of property placed in service during the tax year in excess of $2,010,000 (for 2016; this is also inflation-adjusted annually).

(Cont'd on next page)

Not All Home Mortgage Interest is Deductible; The IRS is Watching

One of the current IRS audit initiatives is checking to see if taxpayers are deducting too much home equity debt interest. Generally taxpayers are allowed to deduct the interest on up to $1 million of home acquisition debt (includes subsequent debt incurred to make improvements, but not repairs) and the interest on up to $100,000 of home equity debt. Equity debt is debt not incurred to acquire or improve the home. Taxpayers frequently exceed the equity debt limit and fail to adjust their interest deduction accordingly.

The best way to explain this interest deduction limitation is by example. Let's assume you have never refinanced the original loan that was used to purchase your home, and the current principal balance of that acquisition debt is less than $1 million. However, you also have a line of credit on the home, and the debt on that line of credit is treated as equity debt. If the balance on that line of credit is $120,000, then you have exceeded the equity debt limitation and only 83.33% ($100,000/$120,000) of the equity line interest is deductible as home mortgage interest on Schedule A. The balance is not deductible unless you can trace the use of the excess debt to either investment or business use. If traceable to investments, the interest you pay on the amount traceable would be deductible as investment interest, which is also deducted on Schedule A but is limited to an amount equal to your net investment income (investment income less investment expenses). If the excess debt was used for business, you could deduct the interest on that excess debt on the appropriate business schedule.

Alternatively, the IRS allows you to elect to treat the equity line debt as "not secured" by the home, which would allow the interest on the entire equity debt to be traced to its use and deducted on the appropriate schedule if deductible. For instance, you borrow from the equity line for a down payment on a rental. If you make the "not secured" election, the interest on the amount borrowed for the rental down payment would be deductible on the Schedule E rental income and expense schedule and not subject to the home equity debt limitations.

However, one of the rules that allows home mortgage interest to be deductible is it must be secured by the home, and if the unsecured election is used, none of the interest can be traced back to the home itself. So, for example, if the equity line was used partly for the rental down payment and partially for personal reasons, the interest associated with the personal portion of the loan would not be deductible since you elected to treat it as not secured by your home.

Using the unsecured election can have unexpected results in the current year and in the future. You should use that election only after consulting with this office.

Generally, people not familiar with the sometimes complicated rules associated with home mortgage interest believe the interest shown on the Form 1098 issued by their lenders at the end of the year is fully deductible. In many cases when taxpayers have refinanced or have equity loans, that may be far from the truth and could result in an IRS inquiry and potential multi-year adjustments. In fact, for Forms 1098 issued after 2016 (thus effective for 2016 information), the IRS will be requiring lenders to include additional information, including the amount of the outstanding mortgage principal as of the beginning of the calendar year, the mortgage origination date and the address of the property securing the mortgage, which will provide the IRS with additional tools for audits.

When in doubt about how much interest you can deduct or if you have questions about how refinancing or taking on additional home mortgage debt will impact your taxes, please call this office for assistance.

Big Business Write-Offs Available Cont'd...

The PATH Act also dealt with the option to revoke the Section 179 election without the consent of the IRS, making it permanent as well; however, once an election is made and revoked, it becomes irrevocable.

In addition, the PATH Act permanently allows the ability to apply Section 179 expensing to off-the-shelf computer software and qualified real property, which is defined as qualified leasehold or restaurant property and retail improvements. In addition, the $250,000 expense limitation and the carryover limitations have been removed. Finally, air conditioning and heating units are eligible for expensing after December 31, 2015.

Bonus Depreciation – Although the PATH Act did not make bonus depreciation permanent, it extended it through 2019 by slowly phasing it out by reducing the bonus percentage. Bonus depreciation allows businesses to take a depreciation deduction in the first year that the property, which must be acquired new, is placed in service. This depreciation can be for as much as 50% in the years 2012 through 2017 before phasing out in 2018 and 2019; it will no longer be available after 2019 without further Congressional action. The following are the bonus depreciation percentage rates through 2019:

- 50% through 2017,
- 40% for 2018 and
- 30% for 2019.

Bonus depreciation generally applies to property with a class life of no more than 20 years. It also applies to:

- Qualified leasehold property (qualified interior improvement to nonresidential property after the building is placed in service).
- Certain fruit- or nut-bearing plants planted or grafted before January 1, 2020.

Luxury Automobile Rates – Bonus depreciation also impacts the first-year deduction for automobiles and small trucks; in the past, this has added $8,000 to the first-year allowable deduction. Now that the bonus depreciation is being extended and phased out, so is the bonus allowance for automobiles and small trucks. Thus, the luxury auto rates will increase based on the following bonus depreciation rates:

- 2015 through 2017 – $8,000
- 2018 – $6,400
- 2019 – $4,800

If you need assistance regarding strategies for your business's use of the Section 179 expense deduction or bonus depreciation, please call this office.

Minimizing Tax on Social Security Benefits

Whether your Social Security benefits are taxable (and, if so, how much of them are) depends on a number of issues. The following facts will help you understand the taxability of your Social Security benefits.

For this discussion, the term "Social Security benefits" refers to the gross amount of benefits you receive (i.e., the amount before reduction due to payments withheld for Medicare premiums). The tax treatment of Social Security benefits is the same whether the benefits are paid due to disability, retirement or reaching the eligibility age. Supplemental Security Income (SSI) benefits are not included in the computation because they are not taxable under any circumstances.

How much of your Social Security benefits are taxable (if any) depends on your total income and marital status.

- If Social Security is your only source of income, it is generally not taxable.
- On the other hand, if you have other significant income, as much as 85% of your Social Security benefits can be taxable.
- If you are married and filing separately, and you lived with your spouse at any time during the year, 85% of your Social Security benefits are taxable regardless of your income. This is to prevent married taxpayers who live together from filing separately, thereby reducing the income on each return and thus reducing the amount of Social Security income subject to tax.

The following quick computation can be done to determine if some of your benefits are taxable:

Step 1. First, add one-half of the total Social Security benefits you received to the total of your other income, including any tax-exempt interest and other exclusions from income.

Step 2. Then, compare this total to the base amount used for your filing status. If the total is more than the base amount, some of your benefits may be taxable.

The base amounts are:

- $32,000 for married couples filing jointly;
- $25,000 for single persons, heads of household, qualifying widows/widowers with dependent children, and married individuals filing separately who did not live with their spouses at any time during the year; and
- $0 for married persons filing separately who lived together during the year.

Where taxpayers can defer their "other" income from one year to another, such as by taking Individual Retirement Account (IRA) distributions, they may be able to plan their income so as to eliminate or minimize the tax on their Social Security benefits from one year to another. However, the required minimum distribution rules for IRAs and other retirement plans have to be taken into account.

Individuals who have substantial IRAs – and who either aren't required to make withdrawals or are making their post age 70.5 required minimum distributions without withdrawing enough to reach the Social Security taxable threshold – may be missing an opportunity for some tax-free withdrawals. Everyone's circumstances are different, however, and what works for one may not work for another.

If you have questions about how these issues affect your specific situation, or if you wish to do some tax planning, please give this office a call.

Take Advantage of the IRA-to-Charity Provision

Individuals age 70.5 or over – who must withdraw annual required minimum distributions (RMDs) from their IRAs – will be pleased to learn that the temporary provision allowing taxpayers to transfer up to $100,000 annually from their IRAs to qualified charities has been made permanent. If you are age 70.5 or over and have an IRA, taking advantage of this provision may provide significant tax benefits, especially if you would be making a large donation to a charity anyway.

Here is how this provision, if utilized, plays out on a tax return:

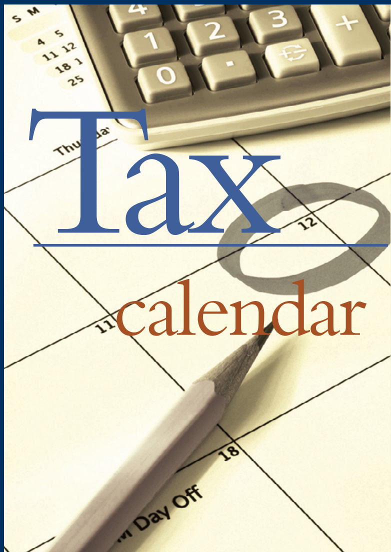
(1) The IRA distribution is excluded from income;

(2) The distribution counts towards the taxpayer's RMD for the year; and

(3) The distribution does NOT count as a charitable contribution.

At first glance, this may not appear to provide a tax benefit. However, by excluding the distribution, a taxpayer with itemized deductions lowers his or her adjusted gross income (AGI), which helps for other tax breaks (or punishments) that are pegged at AGI levels, such as medical expenses, passive losses, taxable Social Security income, and so on. In addition, non-itemizers essentially receive the benefit of a charitable contribution to offset the IRA distribution.

If you think that this tax provision may affect you and would like to explore its possibilities, please call this office.



Tax calendar

June – September 2016

June 15, 2016:
- U.S. citizens living abroad on April 18, 2016 and who have a filing requirement must file a 2015 Income Tax Return (if not already filed) or file for an extension.
- Second installment of 2016 Individual Estimated Taxes due. If your income or deductions have significantly changed, you should call this office to determine if any adjustment in estimates is appropriate.

June 30, 2016:
- Last day to report a financial interest in or signature or other authority over any foreign financial accounts with an aggregate value over $10,000 by filing FinCEN Report 114, more commonly referred to as FBAR. There are no extensions and substantial penalties for failing to file. Caution: the form must be electronically filed (a paper form cannot be filed) by the June 30 date.

June-July 2016:
- Time to review 2016 year-to-date income and expenses to ensure estimated tax payments and withholding are adequate to avoid underpayment penalties.

August 1, 2016:
- Due date for self-employed individuals and employers to file 5500 Series Returns for 2015 calendar year benefit plans (including Keogh/HR-10 plans). Because the normal due date of July 31 is a Sunday in 2016, the due date is changed to Monday, August 1.

September 15, 2016:
- Third installment of 2016 Individual Estimated Taxes due.
- Due date for calendar year partnerships and corporations that were given a 5-month extension to file beyond the April 15 due date.
- This is also the due date for income tax returns (Form 1041) of calendar year estates and trusts that applied for the 5-month extension to file.

October 17, 2016:
- Last day to file calendar year 2015 returns (Form 1040, 1040A, or 1040EZ) on extension without penalty.
- Last day to contribute to a SEP-IRA or Keogh retirement plan for calendar year 2015 if the 2015 tax return is on extension through October 17.

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Since You Asked...

You Asked: A few years ago, my brother got himself into financial difficulties and I loaned him $10,000. He has been unable to pay me back and I have decided to forgive the loan and write it off on my taxes. How do I report my loss on my tax return?

Answer: Non-business bad debts are reported on Schedule D as a short-term capital loss. The information required includes the name of the debtor. The reason for that is a forgiven debt constitutes income to the debtor.

Unfortunately in your case, you cannot write off the $10,000. To be deductible, a non-business bad debt must be enforceable debt and you, as the lender, must make reasonable efforts to collect on that debt. Such efforts to collect include legal action. If you decide to forgive your brother's debt, the loss is nondeductible.

You Asked: I am a self-employed individual, and I occasionally use other people's services. If I pay a person less than the $600 threshold for filing a 1099, I don't bother getting a tax ID number. Sometimes, however, I find myself using that person's services again later in the year, causing the total to exceed the $600 threshold; the person is sometimes reluctant to provide a tax ID at that point. Do you have any suggestions on how to deal with this problem?

Answer: If you use unincorporated independent contractors in your business, I highly recommend that you have them all complete and sign IRS Form W-9 the first time you use their services. That way, you have their SSNs and the contact information you need to file 1099s if the amount you pay them during the year reaches the $600 filing threshold. Having the form also protects you if they give you an incorrect number.

You Asked: I am single and self-employed, and I take an above-the-line deduction for the health insurance premiums that I pay to a well-known insurance company. In addition to medical insurance premiums, does anything else count toward this deduction?

Answer: While the costs of doctor and dental visits, prescription drugs, and other out-of-pocket medical expenses are NOT part of the self-employed health insurance deduction, the premiums for a variety of health coverages are deductible and are often overlooked. These deductions include ACA Marketplace premiums, net of the advance premium tax credit (APTC); payback of any portion of the APTC in the year of the credit; Medicare premiums for parts B, C, and D and for supplemental plans; and premiums for dental insurance, vision insurance, and coverage of lost or damaged contact lenses. Long-term care policy premiums are also allowed, but the deductible amount is limited based on your age.