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tax IMPACT

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Tax Tips
Passive foreign investment company, dealing with concentrated stock positions and more

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5 last-minute tax-planning ideas

Tax planning is a year-round endeavor, but several year end strategies might reduce your 2015 tax bill. Here are five to consider:

1. Defer income, accelerate deductions. You may be able to lower your 2015 income taxes by deferring income to 2016 or accelerating deductions into 2015. To defer income, for example, ask your employer to pay your year end bonus in early 2016. Keep in mind that the bonus must be paid by March 15 to avoid running afoul of deferred compensation rules.

To accelerate deductions, prepay your property taxes, state income taxes or January mortgage payment in December. The most effective way to accelerate deductions is to make contributions to an IRA or other retirement plan, provided you haven't already reached the 2015 limit. Depending on the type of plan, your contributions may be due by December 31, whereas for others you may be able to make 2015 contributions as late as your filing deadline, with extensions. For traditional IRAs, the filing deadline is the due date of the return *without* extension.

Deferring income and accelerating deductions isn't right for everyone. So, if you expect to be in a higher tax bracket next year, you may be better off accelerating income into 2015, when your marginal tax rate is lower, and deferring deductions to 2016, when they'll do more good. Certain deductions are more valuable if you bunch them together in a single year. Medical expenses, for example, are deductible only to the extent they exceed 10% of your adjusted gross income (AGI) (7.5% if you or your spouse is 65 or older). If you won't reach that level this year, consider putting off optional medical care until next year, when you stand a better chance of exceeding the AGI threshold.

2. "Harvest" investment losses. This year, long-term capital gains are taxed at rates as high as 20% at the federal level — 23.8% if you're subject to the net investment income tax (NIIT). If you recognized capital gains this year you may be able to reduce your capital gains tax and the NIIT by selling poor-performing investments at a loss. You can use those losses to offset capital gains, and up to $3,000 in ordinary income. Any losses in excess of the $3,000 allowable amount are "carried forward" for you to use in subsequent years.

3. Avoid estimated tax penalties. If you're behind on estimated tax payments, you may be able to catch up and avoid penalties on your 2015 return by increasing withholdings on your remaining wages and retirement distributions — or, if you file jointly, on your spouse's remaining

Year end tax strategies for business owners

If you own a business, here are several strategies that might reduce your 2015 tax bill:

- Accelerate deductions or defer income — your ability to do so may depend on your accounting method.
- Re-evaluate your accounting method and consider switching from cash to accrual or vice versa if it would help lower your tax bill.
- If your business receives advance payments for performing services or delivering goods, see if you can defer the tax on these payments.
- Make planned purchases of equipment or other depreciable property this year to take advantage of accelerated depreciation deductions — the enhanced Section 179 expensing election and 50% bonus depreciation expired at the end of 2014, but, based on what's happened in the recent past, Congress might extend both of those benefits retroactively to January 1, 2015. Monitor the developments, as the answer may have an impact on your business.
- Review the tangible property regulations — known as the "repair" regulations — to ensure you maximize tax benefits allowed by the regulations.
- Keep an eye on Congress: Lawmakers might extend important tax breaks that expired at the end of 2014, including the R&D credit, depreciation-related tax breaks and the deduction for energy-efficient commercial buildings.

wages — for the year. Unlike estimated tax payments, taxes withheld from wages are treated as if they were paid throughout the year, regardless of when they're actually withheld.

4. Donate to charity. Making charitable donations before year end can reduce your 2015 tax bill. An effective strategy is to donate appreciated stock or other securities that you plan to sell anyway. That way, you'll enjoy a charitable tax deduction for the security's full market value (subject to certain limitations), while avoiding capital gains tax and the NIIT on its appreciation in value. Or, if you're considering donating securities that have lost value, you're better off selling them and donating the cash to charity. Otherwise, you'll miss out on the chance to deduct the capital loss.

5. Watch out for deduction limitations. Note that deduction limitations for high-income taxpayers may reduce the effectiveness of certain strategies. Many itemized deductions are phased out, for example, once your AGI reaches a certain threshold. In 2015, the threshold is $258,250 for single filers and $309,900 for joint filers. If you might be subject to the alternative minimum tax (AMT) this year or next, consider the potential impact of itemized deduction strategies on your AMT liability.

How to get started

To plan for year end, estimate your income, deductions, credits and other tax items for this year and next. Armed with this information and your tax advisor, you can determine which strategies will have the greatest impact on your overall financial situation.

Need a financial backup plan?

Why you should consider a SLAT

The most effective estate-planning strategies often involve the use of irrevocable trusts. But what if you're uncomfortable placing your assets beyond your control? What happens if your financial fortunes take a turn for the worse after you've irrevocably transferred a sizable portion of your wealth?

If your marriage is strong, a spousal lifetime access trust (SLAT) allows you to obtain the benefits of an irrevocable trust while creating a financial backup plan.

Indirect access

A SLAT is simply an irrevocable trust — which may be an irrevocable life insurance trust (ILIT) — that authorizes the trustee to make distributions to your spouse if a need arises. Like other irrevocable trusts, a SLAT can be designed to benefit your children, grandchildren or future generations. You can use your lifetime gift tax and generation-skipping transfer tax exemptions (currently, $5.43 million each) to shield contributions to the trust, as well as future appreciation, from transfer taxes. And the trust assets also receive some protection against claims by your beneficiaries' former spouses or other creditors.

A critical requirement is to fund the trust with your separate property. If you use marital or community property, there's a risk that the trust assets will end up in your spouse's estate.

The key benefit of a SLAT is that, by naming your spouse as a lifetime beneficiary, it gives you indirect access to the trust assets. You can set up the trust to make distributions based on an "ascertainable standard" — such as your spouse's health, education, maintenance or support — or you can give the trustee full discretion to distribute income or principal to your spouse.

There are a few important rules you'll need to follow to ensure a SLAT achieves your objectives. To keep the trust assets out of your taxable estate, you must not act as trustee. You can appoint your spouse as trustee, but only if distributions are limited to an ascertainable standard. If you desire greater flexibility over distributions to your spouse, appoint an independent trustee. Also, the trust document must prohibit distributions in satisfaction of your legal support obligations.

Another critical requirement is to fund the trust with your separate property.

If you use marital or community property, there's a risk that the trust assets will end up in your *spouse's* estate.

Risks

There's a significant risk inherent in the SLAT strategy: If your spouse predeceases you, or if you and your spouse divorce, you'll lose your indirect access to the trust assets. One way to mitigate this risk is to use dual SLATs. In other words, you and your spouse each establish an irrevocable trust using your separate property and naming each other as lifetime beneficiaries.

If you and your spouse set up dual SLATs, design them carefully to avoid running afoul of the "reciprocal trust doctrine." Under that doctrine, the IRS may erase the benefits of spousal trusts if it concludes that the spouses end up in the same economic position as if they had each set up trusts for themselves.

Have your cake and eat it, too

Properly designed, a SLAT allows you to "have your cake and eat it too." You gain the benefits of an irrevocable trust while retaining indirect access to its assets "just in case." ◎

Solving the play-or-pay conundrum

For 2015 and after, employers retaining at least a certain number of employees (generally 50 full-time employees or a combination of full-time and part-time employees) will be subject to the employer shared-responsibility provisions under Section 498OH of the Internal Revenue Code — added to the Code by the Affordable Care Act.

How it might affect your business

Every employer will be affected in the sense that they'll have to check annually to see whether their business and its health care benefits (or lack thereof) trigger consequences under the law. The key determinants are whether you employ a "large" number of employees, and if you do, whether you offer at least a "minimum value" of "affordable" health care coverage to full-time staff.

Meeting the standards of the former but coming up short on the latter could mean penalties if even just one full-time employee receives a premium tax credit for buying individual coverage through one of the new insurance exchanges established in accordance with the act. So the two-part question becomes:

1. Is your company a large employer under the law's definition, and, if so,
2. Are you offering health care coverage that's both of minimum value and affordable?

To determine whether you're a large employer, you need to calculate your full-time equivalent employees (FTEs). Once you've counted your full-timers (defined as employees working 30 or more hours per week), you must total the service hours for all part-timers, divide by 120 and add the result to your total.

If you have hourly employees, base your calculations on records of hours worked and hours compensated (or due to be compensated) for time off because of vacations, illness, disability and other such circumstances.

Penalties can be triggered if just one full-time employee of a large employer receives a premium tax credit via an exchange.

There are several options for determining the hours of salaried part-timers. You can use the same method as for hourly staff, apply a days-worked equivalency method whereby each employee is credited with eight hours per day worked, or use a weeks-worked equivalency method whereby each employee is credited with 40 hours per week worked.

If you have 50 or more FTEs, you're considered to be a large employer. For 2015, however, only employers with 100 or more FTEs are fully subject to the rules. Employers with 50 to 99 FTEs have a one-year reprieve. If you offer health care coverage, you next must assess whether that coverage provides minimum value and is affordable. Regarding minimum value, your plan must cover at least 60% of the total allowed costs of benefits provided.

The "affordability" test generally stipulates that, if your coverage includes an employee premium exceeding, for 2015, 9.56% (the figure is adjusted annually for inflation) of his or her annual household income, your benefits won't be considered affordable. This test applies to the lowest-cost option available, which must meet the minimum value requirement.

Important note: The IRS has proposed three safe harbors for meeting the affordability test. Explore these fully with your benefits advisor.

How you can avoid penalties

There are a couple of ways you could be penalized. Remember, penalties can be triggered if just one full-time employee of a large employer receives a premium tax credit via an exchange. First, if you're not providing health care coverage to at least, for 2015, 70% (increasing to 95% next year) of your full-time employees, the penalty is $2,000 per full-time employee beyond 30 full-timers. (Penalties are based on actual full-time employees, not on FTEs.)

If you're covering the required percentage of your full-time staff but not providing coverage that's of minimum value or affordable, you'll have to pay the lesser of the above penalty or $3,000 for each employee who receives a premium credit from an exchange.

On the bubble?

The play-or-pay penalties loom over many companies. Yes, this can be a burden, but it's critical that employees receive the best health care possible. Work with your benefits advisor. He or she can help you navigate through the technicalities.

tax **TIPS**

Beware the passive foreign investment company

Have you considered investing in a passive foreign investment company (PFIC)? If so, think twice. The rules for such investments are quite onerous, and apply to many foreign investments.

A foreign corporation is a PFIC if 1) 75% or more of its gross income is passive (interest and dividends, for example), *or* 2) at least 50% of its assets are held for production of passive income. In other words, this applies to most foreign-registered mutual funds, hedge funds and private equity funds.

U.S. investors in PFICs are subject to a highly punitive tax regime. In addition to complex, costly reporting requirements, capital gains and dividends generally are taxed as ordinary income at the highest federal rate (currently 39.6%) regardless of your actual tax bracket. Deferred gains or dividends are treated as if they were received ratably over your holding period, and you pay interest on the deferred tax.

To avoid this harsh treatment, file one of two elections that essentially require you to pay tax on PFIC income as it's earned, whether it's distributed to you or not. Fortunately, there are exceptions for the election filing requirements which may apply if you own the PFIC through another entity and if your interest in PFIC shares is below certain thresholds. ◎

Dealing with concentrated stock positions

If investments are concentrated in a single stock, you may want to diversify your portfolio. But selling a large number of shares may trigger a significant tax liability. You can soften the blow by selling your shares over time to spread out the tax burden. Or defer the tax by trading for shares in an exchange fund, or donate shares to a charitable remainder trust, which sells the shares tax-free, reinvests the proceeds and pays you a portion of its income.

If you prefer to keep the stock, diversify your portfolio by buying other securities. If you're short on funds and not averse to some additional risk, you might even buy additional investments on margin, using the stock as collateral. ◎

9th Circuit doubles mortgage interest deduction for unmarried co-owners

Taxpayers are entitled to deduct interest on up to $1 million of acquisition indebtedness and $100,000 in home equity indebtedness on a primary residence and one additional residence. But what happens if unmarried taxpayers own a home together and borrow more than $1.1 million combined?

Recently, the Ninth U.S. Circuit Court of Appeals ruled that the deduction limit applies on a per-*taxpayer* basis, reversing a 2012 Tax Court decision holding that the limit applies on a per-*residence* basis. That is, each co-owner may deduct interest on up to $1.1 million of debt. ◎

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Card, Palmer, Sibbison & Co. has been serving as a trusted advisor and management consultant to owners and businesses in Northeast Ohio since 1920. We have expertise in both the privately held company and not-for-profit area. As certified public accountants we perform the traditional financial and tax services but also provide a wide array of other business services.

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