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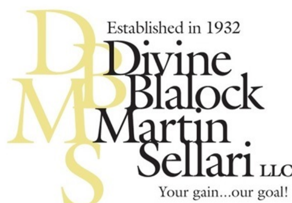

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Tax & Business Alert

MARCH 2015

TAX INCREASE PREVENTION ACT OF 2014 (TIPA)

The Tax Increase Prevention Act of 2014 (TIPA) was signed into law on December 19, 2014. Thankfully, TIPA retroactively extends most of the federal income tax breaks that would have affected many individuals and businesses through 2014. So, these provisions may have a positive impact on your 2014 returns. Unfortunately, these extended provisions expired again on December 31, 2014. So, unless Congress takes action again, these favorable provisions won't be available for 2015.

In this article, we will discuss some of the extended provisions impacting individual taxpayers. Extended business provisions are discussed on page 3.

TAX BREAKS FOR INDIVIDUALS EXTENDED THROUGH 2014

Qualified Tuition Deduction. This write-off, which can be as much as $4,000 for married taxpayers with adjusted gross income up to $130,000 ($65,000 if unmarried) or $2,000 for married taxpayers with adjusted gross income up to $160,000 ($80,000 if unmarried), expired at the end of 2013. TIPA retroactively restored it for 2014.

Tax-free Treatment for Forgiven Principal Residence Mortgage Debt. For federal income tax purposes, a forgiven debt generally counts as taxable Cancellation of Debt (COD) income. However, a temporary exception applied to COD income from cancelled mortgage debt that was used to acquire a principal residence. Under the temporary rule, up to $2 million of COD income from principal residence acquisition debt that was cancelled in 2007–2013 was treated as a tax-free item. TIPA retroactively extended this break to cover eligible debt cancellations that occurred in 2014.

$500 Energy-efficient Home Improvement Credit. In past years, taxpayers could claim a tax credit of up to $500 for certain energy-saving improvements to a principal residence. The credit equals 10% of eligible costs for energy-efficient insulation, windows, doors, and roof, plus 100% of eligible costs for energy-efficient heating and cooling equipment, subject to a $500 lifetime cap. This break expired at the end of 2013, but TIPA retroactively restored it for 2014.

Mortgage Insurance Premium Deduction. Premiums for qualified mortgage insurance on debt to acquire, construct, or improve a first or second residence can potentially be treated as deductible qualified residence interest. The deduction is phased out for higher-income taxpayers. Before TIPA, this break wasn't available for premiums paid after 2013. TIPA retroactively restored the break for premiums paid in 2014.

Option to Deduct State and Local Sales Taxes. In past years, individuals who paid little or no state income taxes had the option of claiming an itemized deduction for state and local general sales

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taxes. The option expired at the end of 2013, but TIPA retroactively restored it for 2014.

IRA Qualified Charitable Contributions (QCDs). For 2006–2013, IRA owners who had reached age 70½ were allowed to make tax-free charitable contributions of up to $100,000 directly out of their IRAs. These contributions counted as IRA Required Minimum Distributions (RMDs). Thus, charitably inclined seniors could reduce their income tax by arranging for tax-free QCDs to take the place of taxable RMDs. This break expired at the end of 2013, but TIPA retroactively restored it for 2014, so that it was available for qualifying distributions made *before* 2015.

$250 Deduction for K-12 Educators. For the last few years, teachers and other eligible personnel at K-12 schools could deduct up to $250 of school-related expenses paid out of their own pockets—whether they itemized or not. This break expired at the end of 2013. TIPA retroactively restored it for 2014.

WHAT ABOUT 2015?

Unfortunately, as we said at the beginning of this article, none of these favorable provisions will be available for 2015, unless Congress takes further action. This is entirely possible, but far from certain. We'll keep you posted as the year progresses. ■

ABLE ACCOUNTS FOR DISABLED INDIVIDUALS

The Tax Increase Prevention Act of 2014 (TIPA) also included another bill, the *Achieving a Better Life Experience Act (ABLE) of 2014.* ABLE establishes a new type of tax-advantaged account for disabled individuals, allowing them to save money for future needs while remaining eligible for government benefit programs.

Beginning is 2015, TIPA allows states to establish tax-exempt ABLE accounts to assist persons with disabilities in building an account to pay for qualified disability expenses.

Note: Although states can establish ABLE accounts beginning in 2015, it is likely they won't be available until after the IRS provides guidance as to how these accounts should be administered. TIPA requires the IRS to provide this guidance by mid-June 2015.

Contributions to an ABLE account aren't deductible for income tax purposes. However, earnings in the account are deferred until distributed from the account or, if the distributions are used to pay qualified disability expenses, they are tax-free.

Except for Supplemental Security Income (SSI), ABLE accounts are disregarded for federal means-tested programs. Also, some ABLE accounts are provided limited bankruptcy protection.

Eligible Individuals. An ABLE account can be set up for an individual (1) who is entitled to benefits under the Social Security disability insurance program or the Supplemental Security Income (SSI) program due to blindness or disability occurring before the individual reached age 26 or (2) for whom a disability certification has been filed with the IRS for the tax year.

Contributions. Annual contributions to an ABLE account are limited to the amount of the annual gift tax exclusion for that tax year ($14,000 for 2015).

Distributions. Distributions from ABLE accounts are tax-free to the extent they don't exceed the designated beneficiary's qualified disability expenses for the year. Distributions that exceed the qualified disability expenses for the year are included in taxable income and are generally subject to a 10% penalty tax.

Distributions can be rolled over tax-free within 60 days to another ABLE account for the benefit of the beneficiary or an eligible individual who's a family member of the beneficiary. Similarly, an ABLE account's beneficiary can be changed, as long as the new beneficiary is an eligible individual who's a family member of the beneficiary.

Death of the Beneficiary. At the beneficiary's death, any amounts remaining in the account after Medicaid reimbursements go to the deceased's estate or designated beneficiary. They are subject to income tax on investment earnings, but not to the 10% penalty. ■

TAX BREAKS FOR BUSINESSES EXTENDED THROUGH 2014

EXTENDED COST RECOVERY PROVISIONS

50% Bonus Depreciation. The Tax Increase Prevention Act of 2014 (TIPA) extended 50% first-year bonus depreciation for an additional year to cover qualifying new (not used) assets that are placed in service in calendar-year 2014. For a new passenger auto or light truck that is subject to the luxury auto depreciation limitations, the 50% bonus depreciation provision increases the maximum first-year depreciation deduction by $8,000.

Generous Section 179 Rules. For qualifying assets placed in service in the tax year beginning in 2014, TIPA restored the maximum Section 179 deduction to $500,000 (same as for tax years beginning in 2013). The temporary rule that allowed up to $250,000 of Section 179 deductions for qualifying real property placed in service in tax years beginning in 2013 was also retroactively restored for tax years beginning in 2014.

15-year Depreciation for Leasehold Improvements, Restaurant Property, and Retail Space Improvements. TIPA retroactively restored the 15-year straight-line depreciation privilege for qualified leasehold improvements, qualified restaurant property, and qualified retail space improvements for property placed in service in 2014.

EXTENDED PROVISIONS FOR BUSINESS

Business Credits. TIPA retroactively extended—

- The research credit to cover qualifying expenses paid or accrued before 2015.
- The deadline for employing eligible individuals for purposes of claiming the Work Opportunity Tax Credit to cover qualifying hires that began work in 2014.
- The credit for eligible small employers that provide differential pay to employees while they serve in the military to cover payments made in 2014. The credit equals 20% of differential pay of up to $20,000 paid to each qualifying employee.

Favorable Rule for S Corporation Donations of Appreciated Assets. TIPA retroactively restored for tax years beginning in 2014 the favorable shareholder basis rule for stock in S corporations that make charitable donations of appreciated assets. For such donations, each shareholder's tax basis in the S corporation's stock is only reduced by the shareholder's *pro rata* percentage of the company's tax basis in the donated assets. Without the extended provision, a shareholder's basis reduction would equal the passed-through write-off for the donation (a larger amount). The extended provision is taxpayer-friendly because it leaves shareholders with higher tax basis in their S corporation shares.

Break for S Corporation Built-in Gains. When a C corporation converts to an S corporation, a built-in gains tax generally applies when built-in gain assets (including receivables and inventories) are turned into cash or sold within the recognition period. The tax is only assessed on built-in gains (excess of FMV over basis) that exist on the conversion date. The recognition period is normally the 10-year period that begins on the conversion date. However, for S corporation tax years beginning in 2012 and 2013, the recognition period was five years. TIPA retroactively restored the five-year recognition period for tax years beginning in 2014. In other words, for gains recognized in 2014, the built-in gains tax won't apply if the fifth year of the recognition period has gone by before the start of 2014.

Energy-efficient Commercial Buildings Deduction. TIPA retroactively restored the deduction for the cost of an energy-efficient commercial building property placed in service during the tax year, for property placed in service before 2015. The maximum deduction for any building for any tax year is the excess (if any) of the product of $1.80 and the square footage of the building, over the total amount of the Section 179 deductions claimed for the building for all earlier tax years.

WHAT ABOUT 2015?

Unfortunately, none of these special provisions will be available for 2015 unless Congress takes further action. This is entirely possible, but far from certain. We'll keep you posted as the year progresses. ■

FOUR GOOD REASONS TO DIRECT DEPOSIT YOUR REFUND

If you are getting a refund this year, here are four good reasons to choose direct deposit:

1. *Convenience.* With direct deposit, your refund goes directly into your bank account. There's no need to make a trip to the bank to deposit a check.
2. *Security.* Since your refund goes directly into your account, there's no risk of your refund check being stolen or lost in the mail.
3. *Ease.* Choosing direct deposit is easy. You just need to provide us your bank account and routing number and we'll take care of it.
4. *Options.* You can split your refund among up to three financial accounts. Checking; savings; and certain retirement, health, and education accounts may qualify.

You can have your refund deposited into accounts that are in your own name, your spouse's name, or both, but not to accounts owned by others. Some banks require both spouses' names on the account to deposit a tax refund from a joint return. Check with your bank for its direct deposit requirements. ■

NATIONAL TAXPAYER ADVOCATE DELIVERS ANNUAL REPORT TO CONGRESS

National Taxpayer Advocate Nina E. Olson recently released her 2014 annual report to Congress, which expresses concern that taxpayers this year are likely to receive the worst levels of taxpayer service since at least 2001 when the IRS implemented its current performance measures. The report recommends that Congress enact a principles-based Taxpayer Bill of Rights, adopt additional safeguards to make those rights meaningful, and provide sufficient funding to make the "Right to Quality Service" a reality.

The report says the combination of the IRS's increasing workload, the erosion of public trust, and the sharp reduction in funding have created a "perfect storm" of trouble for tax administration and therefore for taxpayers. "Taxpayers who need help are not getting it, and tax compliance is likely to suffer over the longer term if these problems are not quickly and decisively addressed," Olson wrote.

The report also urges Congress to enact comprehensive tax reform, pointing out that simplification would ease burdens on taxpayers and the IRS alike. ■

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EXECUTIVE MEMORANDUM
"WHY EXTENSIONS ARE GOOD!"
BY GARY SELLARI, CPA/PFS, MSM
UPDATED JANUARY 2015

When I first started working for the Firm of Divine & Blalock in the early 1970s, only about 15% of the Firm's income tax returns were filed under extension. That was at a time prior to the introduction of Internal Revenue Code Section 444, which virtually eliminated fiscal year-ends for most flow-through business entities and Trusts. As a result of Code Section 444, the tax profession "lost" some planning techniques and strategies. The profession also lost some of its ability to spread out its workload. When Internal Revenue Code Section 444 went into effect, workload compression for the tax preparation industry went up - especially for CPA firms, which generally deal with the more complex business, entities and individual issues.

Workload compression for the Internal Revenue Service also increased with the introduction of Code Section 444 because of its need to deal with literally millions of additional calendar-year entities that, at one time, would have been fiscal year-ends. Also, the rate of tax law change, which has always been high, continues to increase. Recent years' changes (including 2014 changes made just before Christmas, which were mostly retroactive to the beginning of 2014, and more than 500 Internal Revenue Code changes) have gotten worse than ever. The pressure on the IRS to create, distribute and be ready to accept new and changed Forms, the need to change significant amounts of source Code by tax software companies and the need for tax professionals (inside the IRS and outside) to "absorb" all the changes, for simple and more complex matters, only further exacerbates the work period compression problems. In response to such type pressures, **I have been "pressing" for the increased use of extensions, for our Firm's clients, for years**. Also, the IRS remains very receptive (and even desirous) that taxpayers use extensions.

The standard federal extension forms of today automatically extend the filing due date to October 15 for Forms 1040 and to September 15 for calendar-year Trusts, Partnerships and S and C Corporations.

The IRS has made obtaining an extension easy. Today's federal "automatic extension" form does not even ask for a signature – just an estimate of the amount due. The taxpayer(s) no longer even needs to pay the estimated tax due in order to get the extension. The current extension forms (which are now normally "e-filed") basically just ask, "How much do you think you will owe?" and, separately, "How much are you paying?" A timely-filed extension is still valid, even if no estimated tax due payment is made. The taxpayer may have to pay interest and an underpayment penalty on any underpayment amount, but the large, late-filing penalties will not be applicable. The extension is valid. Again, these rules reflect IRS attempts to ease the extension process from their end.

I believe federal tax extensions are generally advisable for numerous tactical reasons that extend well beyond workload compression issues. Based on discussions with numerous tax professionals (both within and outside our Firm), coupled with my own experiences, I continually come to the conclusion that, with very few exceptions, there simply are no adverse consequences or exposures involved in using an extension. In fact, quite to the

contrary, **there are numerous potential benefits that can be obtained by getting a Federal (and where applicable, a State(s)) tax filing extension. Such potential benefits include**:

1. Filing returns beyond the sometimes rushed "crunch time" constraints of "Tax Season" **decreases** the **possibility of error** and/or the overlooking of a planning opportunity(s).

2. Often times, **amended** or initial, extended business returns, **K-1s**, 1099s, etc., are received late or after the initial filing due date. **The chance of IRS audit is definitely lessened** by using the final correct amounts, as the IRS computer-matching mechanisms will be far less likely to "flag" an inconsistency. The reporting details that must accompany the tax reporting schedules from financial institutions on security sales continues to increase. The IRS continues to try to "push" more and more of their work and the details for "computer verify" onto tax preparers, via added reporting requirements on the actual returns and increasing e-filing requirements.

3. We never like to complete a personal return prior to all of that return's related entity's returns being completed, in order to **make sure there is "consistency" amongst the various returns.** Tax positions are often changed, based upon subsequently found facts, circumstances or later realizations. Our **ability to "change our minds"** is compromised, at best, if a return has already been filed. Filing all related returns, using a coordinated overall perspective, significantly increases our ability to defend tax return positions taken, if an IRS audit thereon later arises. Extensions definitely help make that result more possible.

4. Numerous commentators annually state their belief that filing an extension **lowers one's exposure to IRS audit** because of how the IRS processes, organizes and ranks returns for review and/or possible audit. (There is no official way to confirm this, but it is a widely-held belief in the professional tax preparation industry.)

5. There have been numerous instances in the past where tax law, Court cases, Regulation or Congressional legislative actions have **changed tax law**, with potentially retroactive application. More often than not, such later developments have been favorable to taxpayers.

6. If one does get an extension, it is true that might delay a refund. However, in general, refunds arise from overpaying one's taxes. From a tax-planning perspective, **our goal is not to get refunds – it is to minimize our clients' overall taxes**.

7. The only specific election I can think of, which could be adversely affected by getting an extension, is the election to take a tax deduction for a casualty loss in the year prior to the tax year the loss actually occurred. That election must be made by the related return's initial due date. (Note – there could be limited application to the "trader" election, but that election can be made by the necessary April 15 deadline, separate from an extended tax return.)

8. **Extensions often provide more time to make tax-deductible retirement plan contributions**. Such contributions are generally still deductible if made by the due date of the related return, including extensions.

9. Whenever a "flow-through" entity return is filed by the initial due date, an extension of the personal return **can actually shorten the statute of limitations' audit exposure period.** That is because the IRS generally only has three years to audit. For example, if a flow-through entity return is filed by March 15, 2015, but the related personal return is not submitted until the following October 15, 2015, the IRS only has until March 15, 2018 to audit the entity return so as to change the personal return. Thus, the personal (1040) return exposure period was reduced, as a practical matter, at least as to that entity's relevance, from October 15, 2018 to only March 15, 2018. Sometimes that can be a potentially helpful/useful strategy.

10. If an IRA was rolled over to a **Roth IRA**, the Roth IRA can be re-characterized back to a traditional IRA by the due date of that year's return, including extensions. Thus, an extension provides **added "hindsight"** ability to the **"re-characterize or not"** decision.

11. One major reason to extend, which often results in significant benefit by filing later in the following tax year, is the sometimes very useful **perspective gained by having more hindsight and more perspective on the current year** to make tax return preparation decisions for the prior year. Decisions such as – "Should I capitalize now or write-off?" "Should a particular payment be classified as a loan, distribution, reimbursement or other?" "Should a certain election be made or not that affects more than one year?" "Should a carry-back be used or instead be saved for carry-forward purposes?" etc., etc. The ability to have an increased **"hindsight/current year perspective window"** can only be obtained by using extensions.

Our Firm currently files well over half of our clients' returns using extensions. **Purely from a tax-planning, client-oriented, consultative perspective, I would like to see us use extensions for even more of our returns (other than the very simplest ones)**. I regularly encourage the use of an extension, even when a return has otherwise been completed. We want to take as much advantage as possible of the above-listed, client-oriented, potential benefits. Of course, we realize that many clients, for various reasons, do not want to extend. We try to accommodate them – sometimes even despite our belief that such may not be in that client's ultimate best interest.

(Note – many States are not as "accommodating or lenient" with their extension rules and procedures as the IRS. Special care may be needed for clients with State tax return filing obligations.)

We continually strive to meet (and more often than not achieve) our Firm's stated goal – *"To make or save for you far more than you invest in us."*