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The Beginning of the End

Tax practitioners start preparing their year-end planning strategies

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As tax planners and their clients look toward the end of the year, most of their current planning concerns center around two major items: the Affordable Care Act, and the fate of the "extenders." Together, they generate multiple planning issues.

"Be prepared to explain the Net Investment Income Tax to your clients," said Matthias Weber, a tax principal at Haskell & White. "One of the biggest issues is to get comfortable with the concept of the tax, which was created to offset the costs of Obamacare. A lot of individual clients are misinformed from what they hear about it."

Weber recommends that taxpayers take advantage of unrealized losses: "It's extremely important given the last two years in the stock market. Advisors should circle back with their individual clients to see if there are any unrealized losses in certain positions. This would be a great time to have a discussion with clients about realizing losses to offset the gains from the previous two years."

Much of the planning regarding Tax Code provisions that have expired and not yet been renewed will be tentative at this time, Weber observed.

"My belief is that they'll always be extended," he said. "For better or worse, our economy is driven off of a consumption base, and most of the extenders are consumption-oriented. For example, the benefit of bonus depreciation is you have to buy a new asset. This drives the economy."

Weber cautions that every client's facts and circumstances are different, and that planners should get to know their clients' objectives. "I meet at a minimum twice a year with clients to get an idea of where they see their business going and what are their goals," he said. "If they're in a non-growth cycle, it may be important to maintain it and not to spend cash, but if they're trying to grow into a new region or market, I would advise them to take full use of bonus depreciation for however long it will last."

CRYING WOLF?

Mark Luscombe, principal analyst at Wolters Kluwer, CCH, cited the extenders as an issue. "Every other year,

we're faced with expiring provisions, and we are again this year," he said.

"It almost feels like we cry wolf every couple of years because we warn everyone of the issues, but we manage to get them extended retroactively," Luscombe continued. "The House has been doing one-off bills, suggesting extending particular provisions without considering the whole, while the Senate has come up with an extenders bill for the whole package. Nothing will happen before the election, which is what people have been predicting all year. It leaves tax planners in a quandary as to whether they should assume some provision is not available, or will be retroactively extended."

"The 2012 extenders got extended on January 1 of 2013," he said. "They put in a special provision for the distribution to an IRA for charity that the taxpayer could treat a distribution in January as if it had been done in December. So there's precedent that if you wait, Congress will try to accommodate the fact that you waited. It's hard to put off planning for a particular transaction until you know what Congress is going to do. For example, on the issue of whether or not to purchase equipment, you may not be able to put that off until December."

Luscombe urges planners to be thinking about health care reform issues. "For example, under the individual mandate, they should have had insurance in place for the year; otherwise, they're subject to a penalty. They can still take action to reduce the potential penalty."

"There's also the question of who is eligible for a subsidy," he added. "Some people got an advance subsidy and others are trying to figure out if they will be entitled to it when they file their taxes. They may get an additional credit or have to return some of the credit they got when they signed up on an exchange."

Then there's the routine year-end planning details. Luscombe noted. "Look over investments to see if there is anything to do before year-end to sell and ideally end up where you want to regarding capital gain and losses. The new tax of 3.8 percent on net investment income gives another number to plan around, by keeping below the level it kicks in, or keeping items out of the NII category."

Then there's the possibility of bunching deductions to maximize year-end planning, Luscombe observed. "With medical deductions, there's a 10 percent floor, so you can look at the possibility of bunching them into one year so as to qualify for the maximum deduction. Every place there's a phase-out, it gives another planning opportunity to see if you in fact qualify for the deductions you're hoping to qualify for."

TANGIBLE ISSUES

Chuck Schultz, a partner on McGladrey's Washington National Tax team, noted that the IRS released regulations regarding the deduction and capitalization of tangible asset costs that were effective beginning in 2014. "It impacts every taxpayer that acquires, produces or improves tangible property," he said.

"A big focus for us related to year-end planning has been directed to tangible assets and repairs. Many middle-market companies with tangible assets, including but not limited to machinery, equipment, supplies, furniture, fixtures, and the building itself, need to address this issue," Schultz noted.

"For many companies, the need to establish a policy regarding the purchase of tangible assets as well as establishing a stricter protocol regarding the manner that assets are purchased has to be established prior to year-end. This can go a long way to ensure that certain asset purchases or asset repairs are expensed or capitalized compliantly."

"We're in an environment of uncertainty, with tax provisions that have lapsed and haven't been reinstated," said Mike Solomon, a tax partner at EisnerAmper. "We just don't know if they're coming back. These include things like bonus depreciation, the enhanced 179 deduction, the R&D credit, and at the individual level a host of things including the deduction of sales tax for those in states that do not have an income tax. These are provisions that we used to count on, that are now being held hostage by gridlock."

"So much depends on depreciation. For real estate investors, distributors and manufacturers, depreciation is a big part of tax planning, and the amount of bonus depreciation and expensing is completely up in the air now," he said. "Even if they get the Section 179 amount reinstated, there's only a certain amount of acquisitions you can make in the time left."

New planning being done for individual owners of business has to do with the Net Investment Income Tax, said Solomon. "There is an exemption if you are materially active in the business. ... Income from the business is not considered subject to the NIIT."

"If it's business, you're not subject to the NIIT, but if it's passive or investment income to you then it is subject to NIIT. The government specifically made no bright-line test for the determination - it's facts and circumstances driven. The reason is, they don't want people to pre-arrange their affairs to comply with a specific test. They intentionally made it fuzzy. This is a huge planning issue, and it's fairly recent. This is the first year dealing with new regulations on the subject."

"Everything is up in the air until the extenders issue is settled," said Sachiko Danish, tax senior manager at Moss Adams. "Most of my clients are individual taxpayers, many of whom are also business owners. We're looking at a maximum Section 179 deduction of $25,000, but we expect the extenders to be reinstated, and that will be a help for business owners."

BE OVER-PREPARED

"Never stop preparing for tax season," said Gary Cooper, of Houston-based Cooper CPA Group PC. "With the current changes and uncertainty, you have to stay informed and communicate these changes to your team and clients. In addition to calling affected clients directly when the Tax Code changes, we release a monthly e-newsletter to keep everyone informed. Continuing education and internal training of preparers are also paramount."

"The IRS is becoming increasingly aggressive," he noted. "Reasonable compensation for an officer of a company is now a very hot audit item for the agency. Another issue is Form 1099-MISC for independent contractors. Make sure you follow IRS guidelines and have all agreements in writing, along with Form W-9 on file. Tread lightly in tax

areas with unclear Tax Code and regulations, as it could leave your client vulnerable to years of expensive audits by the IRS."

The two biggest concerns in planning are the status of the extenders and health care, agreed Roger Harris, president of Padgett Business Services. "With the extenders, we want to know when and if they will be extended," he said. "A lot depends on how the elections turn out, and whether or not Congress will stay divided."

"With the ACA, we should begin the process of alerting clients how they could be impacted, and what clients need to bring in with them to get their taxes done," he said. "There are forms they may need that they've never seen before, and questions they've never been asked before. Preparers will have to schedule interviews knowing they will take more time."

"Everyone will have to at least have coverage of health insurance and show proof. If not, we may have to calculate a penalty or apply for a hardship exemption," he added. "If we have a large employer that has to provide insurance for 2015, we have to make them aware of it. ... If they are, they need enough time to make determinations and set up a plan so they can offer it during the enrollment period at the end of 2014 long before we see them with their tax returns."

"For smaller employers who have been offering health insurance, we still have to make sure they understand what their and their employees' rights and responsibilities are, even though they're not covered by the employer mandate," he continued.

"So there are a lot of things we should be talking about with our business clients before the end of the year to make sure the filing season will go as smoothly as possible," he said. "And on top of that, we still have to do our normal year-end tax planning. Nothing has gone away, we just have more to do. Whatever tax planning tools or strategies we had are still there, but on top of that we have these other issues."

Although the fate of the extenders is up in the air, there is still the opportunity for some planning, observed Evan Stephens, tax manager at Sensiba San Filippo.

"Taxpayers can accelerate deductions by paying real estate taxes early, and if they are likely to owe any state income tax come April, it may be wise to pay in December to accelerate the deduction," he suggested.

"Be aware of tax-exempt investments like municipal bonds," he cautioned. "They're generally tax-exempt for both federal and home-state purposes. But it doesn't hold true for all states, and be aware that there is such a thing as private-activity bonds. These can still be taxed for [Alternative Minimum Tax] purposes. They may look like municipal bonds, but they can still be taxed on AMT."

"And although Congress has not yet committed to reinstate the added benefits of bonus depreciation on fixed asset purchases for 2014, there is still a much smaller benefit through a Section 179 deduction of up to $25,0000," he said.

"And a small blip in the code allows for a much larger, $500,000 deduction under Section 179 for non-calendar-year taxpayers whose tax years began in 2013, but end in 2014. This may benefit some taxpayers who do not carry a calendar year-end."

"While long-term capital gains still maintain their preferential rates, they are subject to the additional 3.8 percent Medicare investment tax. Short-term capital gains are subject to ordinary income rates and the 3.8 percent Medicare tax. Tax deferral mechanisms for significant tax gains should be considered, such as a Section 1031 like-kind exchange for real property sales, or structuring the sale as an installment sale," he advised.

Stephens urged practitioners to have their clients maximize contributions to tax savings and retirement vehicles.

"Revisit decisions to contribute to a traditional versus a Roth retirement plan," he suggested. "If a taxpayer is hovering around the threshold for the new Medicare tax, the taxpayer should consider moving Roth contributions to a traditional retirement plan, since maximizing contributions to a traditional plan could reduce taxable income below the threshold and, therefore, avoid the additional 3.8 percent tax on investment income."