

# tax report

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## Congress Extends Many Tax Breaks

At the end of last year, Congress continued its tradition of passing an “extender package.” Typically, the year-end packages extend various tax benefits for one year only, but this most recent legislation — the Protecting Americans from Tax Hikes (PATH) Act of 2015 — extended many benefits for longer periods, and in some cases, permanently.

### Individuals

Following are some of the more important provisions affecting individual taxpayers:

**State and local sales taxes.** The new law permanently extends the provision allowing taxpayers to take an itemized deduction for state and local *sales* taxes rather than state and local *income* taxes. This provision may be useful to individuals who live in states with no income tax or who have purchased an expensive item, such as a car.

**American Opportunity Tax Credit.** Also made permanent is the tax credit of up to \$2,500 per year for the payment of qualified tuition and related expenses for the first four years of post-secondary education. The credit is subject to phaseout based on income level.

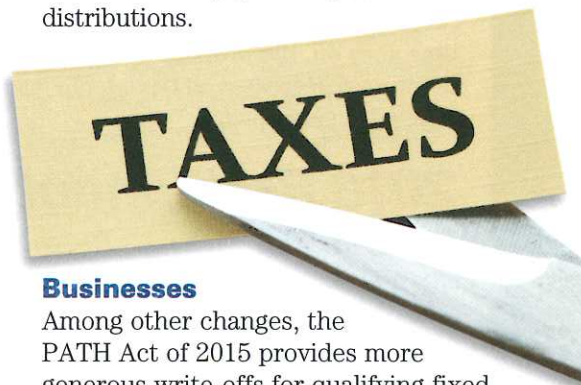
### Higher education expense deduction.

This provision allows eligible individuals to deduct up to \$4,000 or \$2,000 (depending on income) of qualified tuition and related expenses. Because the deduction is “above the line,” taxpayers do not need to itemize to take it. The deduction is extended for 2015 and 2016.

### Nontaxable IRA charitable transfers.

Under this provision, now permanent, individuals

age 70½ or older may exclude from gross income up to \$100,000 per year for direct transfers from their individual retirement accounts to qualifying charities. If all requirements are met, such contributions also count toward the taxpayer’s required minimum distributions.



### Businesses

Among other changes, the PATH Act of 2015 provides more generous write-offs for qualifying fixed asset purchases:

**Higher Section 179 limit.** Effective for the 2015 tax year, the new law makes permanent the \$500,000 limit on the cost of machinery, equipment, and other eligible property that businesses may expense each year. The election is subject to a dollar-for-dollar phaseout once the cost of expensing-eligible property exceeds \$2,000,000.

**“Bonus” first-year depreciation.** Thanks to the new law, businesses will continue to have the option of deducting 50% of the cost of qualifying property (e.g., most machinery and equipment) in the year the property is placed in service. The 50% “bonus” depreciation percentage is available for 2015, 2016, and 2017. The percentage drops to 40% in 2018 and to 30% in 2019. ■

## Keep It or Toss It?

As you were gathering your paperwork for your 2015 income-tax return, you may have wondered if you could get rid of some of your old documents. Here are some general guidelines:

- Hold on to copies of federal and state tax returns indefinitely. These may be useful for the preparation of future tax returns and for making computations for an amended return, if one is necessary.
- Retain records used to prepare your return — including W-2s, 1099s, canceled checks, receipts for charitable donations, and records relating to property transactions — at least three — but preferably six — years. The IRS generally has three years from the later of the return’s due date or the actual filing date to assess a deficiency, but it will have additional time to do so in certain situations.

## short takes

### Increase in *De Minimis* Limit

Businesses making the *de minimis* safe harbor election to expense certain purchases of equipment and other tangible property in the year of acquisition should be aware that the IRS recently announced an increase in the expensing threshold for taxpayers who don't have "applicable financial statements." For these taxpayers, the limit is raised from \$500 to \$2,500 per invoice (or per item as substantiated by the invoice). For taxpayers with applicable financial statements, the limit remains \$5,000 per invoice or per item.

### Estate-tax Filings Increased in 2014

According to the IRS, the number of estates filing a federal estate-tax return increased 12.9% from 2013 to 2014. However, only 43.2% of those estates were taxable. One reason to file a federal return for a nontaxable estate is to preserve the unused exclusion amount for the surviving spouse.

### Law Eliminates Social Security Claiming Strategies

Two popular claiming strategies for Social Security benefits — known as "file and suspend" and "restricted application" — were eliminated by the Bipartisan Budget Act of 2015. These strategies had been used by some married couples to maximize their benefits. While some older individuals may be grandfathered under the new rules, others may want to consider additional strategies still available.

*The general information in this publication is not intended to be nor should it be treated as tax, legal, investment, accounting, or other professional advice. Before making any decision or taking any action, you should consult a qualified professional advisor who has been provided with all pertinent facts relevant to your particular situation.*

## Should You Prepay Your Mortgage?



If you are looking for a long-term strategy for saving money, consider making extra principal payments toward your mortgage. Those payments can substantially reduce the amount of interest you pay and shave years off the term of your loan.

### How It Works

As you know, when you take out a mortgage loan, you are agreeing to pay back the borrowed principal at a certain interest rate over a fixed number of years. Each monthly payment is allocated to principal and interest, and, as time goes on, the proportion allocated to interest decreases as the overall loan balance is paid down.

By making extra principal payments, you reduce the principal earlier and will reduce the total interest you pay. A simple way to make extra payments is to divide your monthly principal and interest payment by 12 and add that amount to each monthly payment.

### Tax Effects

A potential disadvantage of prepaying principal is a reduction of the itemized deduction generally allowable for payments of home mortgage interest. For example, if you are in the 28% tax bracket, every \$1 of mortgage interest paid is potentially 28¢ in tax savings. On the other hand, each \$1 of interest eliminated is \$1 saved.

### First Things First

Check with your lender to make sure prepayment penalties don't apply. Also, instruct the lender to apply the extra amount of each payment directly to your principal. ■

## 2016 Retirement Plan Limits

The IRS made very few cost-of-living adjustments to the contribution limits that apply to various retirement plans for the 2016 tax year. Following are some of the key limits.

**Defined contribution plans.** The dollar limit on salary deferrals to a 401(k), 403(b), or governmental 457 plan remains unchanged at \$18,000. The limit for additional catch-up contributions (available to participants age 50 and older if their plan allows) also remains unchanged at \$6,000.

The annual additions limit — which applies to the combined contributions of the employer and employee to a defined contribution plan — remains unchanged at \$53,000. (Catch-up contributions do not count toward the limit.)

**SIMPLE IRAs.** The limits on employee contributions and catch-up contributions remain at \$12,500 and \$3,000, respectively.

**Individual retirement accounts (IRAs).** The limits for contributions and catch-up contributions to traditional and Roth IRAs remain unchanged at \$5,500 and \$1,000, respectively.

Individuals who contribute to traditional IRAs and have access to a workplace retirement plan (whether their own or through their spouse's plan) will see minor changes in the income-level phaseout ranges that apply for purposes of making deductible contributions. The ranges, which are based on modified adjusted gross income (MAGI), are:

■ \$61,000 to \$71,000 for single taxpayers and heads of household covered by a retirement plan at work (unchanged from 2015)

■ \$98,000 to \$118,000 for married couples filing jointly when the spouse contributing to the IRA is also covered by a workplace retirement plan (unchanged from 2015)

■ \$184,000 to \$194,000 for married couples filing jointly when the spouse contributing to the IRA is not the spouse with the workplace retirement plan (up from \$183,000 to \$193,000 in 2015)

The income-level phaseout ranges for Roth IRA contributions are \$184,000 to \$194,000 (married filing jointly) and \$117,000 to \$132,000 (single and head of household). ■

# Structuring Your Business

Ready to start a new business? Before you do, know that the structure you choose will affect how your business is taxed and your potential liability exposure.

## Sole Proprietorship

If you are the only owner, you can choose to operate your business as a sole proprietorship. (It is also possible for spouses to conduct a single business as a sole proprietorship.) For federal income-tax purposes, you report your business income and expenses on Schedule C, an attachment to your personal return (Form 1040). Net earnings from the business are subject to both self-employment taxes and income taxes.

One significant issue for a sole proprietorship is the lack of liability protection. The sole proprietor's personal assets can be used to satisfy the claims of business creditors.

## Corporation

A corporation is a separate legal entity that transacts business in its own name. Although a corporation can be large and have thousands of shareholders, even a small business with one owner can incorporate.

**C corporations.** The corporation files its own income-tax returns and uses a corporate tax rate schedule to figure the taxes due.

The two main ways that the owner takes money out of a corporation are through a salary and dividends. Generally, the owner's salary may be deducted by the corporation as a business expense. The corporation may also choose to distribute corporate earnings as dividends to the shareholders. However, the income will be taxed a second time to the shareholders, and the corporation will receive no deduction for the dividend payments.

Assets of the corporation are separate from those of the shareholders, so creditors may generally look only to the corporate assets for satisfaction of their claims.

**S corporations.** An S corporation offers the limited liability of a corporation without the double taxation associated with dividend distributions from a C corporation. The S corporation files

income-tax returns but generally does not pay federal income taxes itself. Instead, the shareholders are taxed individually on their respective shares of the corporation's taxable income.

When S corporation shareholders perform services for the entity, the IRS may treat dividends paid in lieu of reasonable compensation as wages subject to employment taxes.

## Partnership

A partnership has two or more owners. It must have at least one general partner who is liable for the partnership's debts and obligations, though other investors may limit their potential liability by taking limited partnership interests.

Partnerships do not pay federal income taxes but must file an informational return with the IRS. Profits and losses are divided among the partners according to the terms of the partnership agreement and are taxed to them individually.

## Limited Liability Company

A limited liability company (LLC) is a separate legal entity that can have one or more owners (called "members"). Depending on the elections made by the LLC and its members, the IRS will treat it as a corporation, a partnership, or as part of the LLC owner's individual tax return.

Like an S corporation, an LLC offers both liability protection and "pass-through" taxation, though it may offer more flexibility in terms of allocations of special tax benefits and allowable ownership interests. ■

## Calendar of Filing Dates



### MARCH

**15 Corporations:** Calendar-year corporations file 2015 tax return (Form 1120) and pay any tax due. S corporations file Form 1120S. For an automatic six-month filing extension, file Form 7004 and deposit the estimated tax due.

**31 Employers:** Electronic filers must file 2015 Forms W-2 with the Social Security Administration.

### APRIL

**18 Individuals:** Most calendar-year taxpayers file 2015 income-tax return (Form 1040, 1040A, or 1040EZ) with the IRS. (Residents of Massachusetts and Maine have until April 19.) For an automatic six-month extension, file Form 4868 and pay the estimated tax due.

**18 Individuals:** Pay the first installment of 2016 estimated tax.

**18 Partnerships:** File 2015 calendar-year partnership return (Form 1065). For an automatic five-month extension, file Form 7004.

**18 Corporations:** Deposit first installment of 2016 estimated tax.

### MAY

**2 Employers:** File Form 941, Employer's Quarterly Federal Tax Return; quarterly deposit due for those who meet the safe harbor requirements.

**10 Employers:** Deferred due date for Form 941, if timely deposits were made.

**16 Exempt Organizations:** File 2015 Form 990, 990-EZ, or 990-N, if the organization reports on a calendar-year basis.



## Dividing Retirement Assets in a Divorce

Retirement assets — whether in an employer-sponsored retirement plan or individual retirement account (IRA) — are often among a couple's largest assets. That's why separating couples should carefully follow the rules for the transfer of these assets.

### Qualified Plans

To divide assets in a qualified employer-sponsored plan, the couple should obtain a qualified domestic relations order (QDRO). Generally, a QDRO is a judgment, decree, or court order issued under a state's domestic relations law that:

- Recognizes someone other than the plan participant as having a right to receive benefits from a qualified retirement plan (such as a 401(k), profit sharing, or defined benefit plan),
- Relates to payment of child support, alimony, or marital property rights to a

spouse, former spouse, child, or other dependent of the participant, and

- Specifies certain information, including the amount or part of the participant's benefits to be paid to the participant's spouse, former spouse, child, or other dependent.

For tax purposes, benefits paid under a QDRO to the plan participant's spouse or former spouse generally have to be included in the spouse's or former spouse's income. Benefits paid to the plan participant's child or other dependent are treated as though they were paid to the participant. The 10% early withdrawal penalty does not apply to payments made from a qualified retirement plan to an alternate payee under a QDRO.



### IRAs

The transfer of an IRA to a spouse or former spouse pursuant to a divorce instrument is not a taxable transfer. Couples typically transfer IRA assets with a direct trustee-to-trustee transfer or by changing the name on the IRA. After the transfer, the IRA is treated as the spouse's. ■