November 2015

To our clients and friends,

Tax planning season is upon us yet again! Unfortunately, there is some uncertainty with tax law again this year. History may repeat itself; as in the past, Congress has allowed certain tax breaks to expire. At the last minute, they may decide to extend them for a year or two. Hopefully, Congress will act quickly and extend some of the tax breaks that expired in 2014.

Since there is no guarantee as to what Congress will do, the best strategy is to understand and plan for your tax situation as if Congress will and will not pass an extension. That way you will be ready regardless of what happens.

**Here are some of the tax breaks that expired at end of 2014 and have yet to be renewed:**

**Individuals**
- Above-the-line deduction for certain expenses incurred by teachers
- Above-the-line deduction for qualified tuition and related expenses
- Tax-free distributions from individual retirement accounts (IRAs) to charitable organizations

**Businesses**
- Research and development (R&D) credit
- Increased limitation of $500,000 in Section 179 expenses, $2 million phaseout threshold, and expanded definition of Section 179 property
- 50% bonus depreciation
- Fifteen-year straight-line cost recovery for qualified leasehold, restaurant, and retail improvements

As you begin tax planning, it is important to try to predict the tax bracket you will be in for 2015 and 2016. Effective tax planning requires looking at the current and at least the following year’s tax bracket. While reducing your taxes for 2015 to the maximum extent possible will save you money for 2015, it may mean you will end up paying more taxes in 2016 than if you would have considered both years together.

Normally, because of the time value of money, it’s better to pay taxes later rather than sooner. However, you must consider the tax bracket that you will be in for 2015 and 2016. Accelerating income and pushing off deductions in the year you are in a lower tax bracket is usually a good strategy. Paying more tax in 2015 might make sense if you expect to be in a higher bracket next year. However, minimizing your 2015 income taxes might not be the best move when you look at both 2015 and 2016.

It is also important to be aware of your marginal tax rate. The marginal tax rate is the additional tax, expressed as a percentage, generated by $1 of additional taxable income. In some cases, the marginal tax rate could be several percent higher than what the tax rate brackets would indicate, due to phase-outs and other taxes that might apply.

How do you shift income and deductions between tax years? The most common techniques involve focusing on income or deductions that you can easily control. Deductions like real estate taxes, charitable contributions, and state estimated tax payments are easy to control because the deduction is based on when the item is paid. If you own a business, depreciation on your 2015 fixed asset purchases is also somewhat controllable, as there are a few different options for depreciation in 2015. Cash basis businesses can control the amount of expenses that they do or do not pay by the end of the year. Controlling income is somewhat more difficult but may be accelerated by sending invoices to your customers in time to still receive payment in 2015.

**Here are a few tax-saving ideas to get you started.**

**Ideas for your business**

**Ideas for individuals**

**Ideas for maximizing nonbusiness deductions**

**Effective tax planning for investments and making the most of year-end securities transactions**

**Health insurance coverage and Health Savings Accounts (HSAs)**

**Ideas for the office**

**IRAs — Roth and traditional**

**Don’t overlook estate planning or gifting**

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Ideas for your business

Take advantage of tax breaks for purchasing equipment and software. If you plan to buy computers, office furniture, equipment, vehicles, or other tangible business property, you might consider doing so before year-end to capitalize on the following tax breaks:

- **Section 179 deduction.** Your business may be able to take advantage of the Section 179 deduction. Under the Section 179 deduction, an eligible business can claim first-year depreciation write-offs for new and used equipment and software additions. (However, limits apply to the amount that can be deducted for most vehicles.) Unless the more generous amounts are extended for 2015, the eligible amount of Section 179 is substantially reduced for tax years beginning in 2015. The maximum deduction is $25,000, with the cap on property purchases at $200,000. The very low cap of $200,000 property purchases will mean many businesses are not eligible to claim the Section 179 deduction in 2015.

- **50% first-year bonus depreciation.** Bonus depreciation is currently not allowed for assets placed in service beginning January 1, 2015, regardless of your tax year. If bonus depreciation is not retroactively reinstated back to January 1, 2015, your federal tax depreciation could be significantly less than it was for 2014, thus creating taxable income. If it is reinstated for 2015, taxpayers who take advantage of bonus will have more tax depreciation. Tax planning should be done under both scenarios to be ready to carry out the appropriate planning strategy the minute it is known what the law will be.

We have enjoyed bonus depreciation for most tax years since 2001. Because of the many years of bonus depreciation, it is imperative for businesses to monitor their 2015 and 2016 tax depreciation expenses. If bonus depreciation has been maximized in the past, businesses will most likely see a dramatic drop in their tax depreciation expense in the short term if bonus depreciation is allowed to expire, thereby creating additional taxable income as compared to book income. If bonus depreciation is reinstated, this will help to keep tax depreciation at higher levels. All taxpayers should be annually monitoring their book and tax depreciation differences to prevent surprises down the road. Businesses that have benefited from bonus depreciation have deferred taxes that will be due sooner than later if bonus is not reinstated.

**Changes in Wisconsin Depreciation.** As a reminder, Wisconsin changed its laws with regard to depreciation starting with the 2014 tax year. Prior to 2014, Wisconsin never allowed bonus depreciation or the increased federal Section 179 amounts. Therefore, there was a significant difference in the remaining basis of a fixed asset for federal and Wisconsin. Wisconsin requires that difference to be amortized over five years starting with the 2014 tax year.

Should Congress retroactively reinstate bonus depreciation for calendar year 2015, as in the past, Wisconsin will not adopt bonus depreciation. However, should an increased Section 179 be reinstated for 2015 tax years, Wisconsin WILL adopt the increased Section 179 amount. You are able to elect different Section 179 amounts for federal and Wisconsin.

**Impact of the new repair regulations.** In late 2013, the IRS issued new regulations to provide guidance on when an improvement to tangible property needs to be capitalized or when it can be expensed. These regulations are generally effective for tax years beginning on or after January 1, 2014. While there are a few bright line tests, the new regulations are still very subjective. The good news is that the new regulations are generally more favorable to taxpayers in that it may be easier to call an improvement a repair that does not require capitalization. A few reminders:

- Increased ability to expense purchases: the new regulations allow taxpayers with audited financial statements to expense capital expenditures up to $5,000 per item or invoice, without scrutiny. Other taxpayers are allowed only $500. Certain requirements must be met.

- An improvement to tangible property must be capitalized if it is a betterment, restoration or adaptation of the property. The dollar amount of the improvement is not necessarily considered. If it is not a betterment, restoration or adaption, then the item is considered a repair and can be expensed.

- Routine maintenance on personal property is more clearly defined so that there is clearer distinction between a repair and something that must be capitalized.

**Claim the health insurance tax credit for small employers.** Some qualifying small employers can claim a tax credit that can potentially cover up to 50% of the cost of providing health insurance coverage to employees. An employer is only eligible for the credit if the group insurance is purchased through the SHOP marketplace (exchange). A qualifying small employer is one that: (1) has no more than 25 full-time equivalent (FTE) workers, (2) pays an average FTE wage of less than $50,000 and (3) has a qualifying health care arrangement in place. The allowable credit is quickly reduced under a complicated phase-out rule when the employer has more than 10 FTE employees or an average FTE wage in excess of $25,800.

**Evaluate inventory for damaged or obsolete items.** Inventory is normally valued for tax purposes at cost or the lower of cost or market value. Regardless of which of these methods is used, end-of-the-year inventory should be reviewed to detect obsolete or damaged items. The carrying cost of any such items may be written down to their probable selling price (net of selling expenses). Note: this rule does not apply to businesses that use the last in, first out (LIFO) method because LIFO does not distinguish between goods that have been written down and those that have not.

To claim a deduction for a write-down of obsolete inventory, you are not required to scrap the item. However, in a period ending not later than 30 days after the inventory date, the...
item must be actually offered for sale at the price to which the inventory is reduced.

**Employ your child.** If you own a business, don’t miss one last opportunity to employ your child before the end of the year. Doing so has tax benefits in that it shifts income (which is not subject to the Kiddie tax) from you to your child, who normally is in a lower tax bracket or may avoid tax entirely due to the standard deduction. There can also be payroll tax savings since wages paid by sole proprietors to their children age 17 and younger are exempt from both Social Security and unemployment taxes. Employing your children has the added benefit of providing them with earned income, which enables them to contribute to an IRA. Children with IRAs, particularly Roth IRAs, have a great start on retirement savings since the compounded growth of the funds can be significant.

Remember a couple of things when employing your child. First, the wages paid must be reasonable given the child’s age and work skills. Second, if the child is in college or entering college soon, having too much earned income can have a detrimental impact on the student’s need-based financial aid eligibility. However, this also provides your college-age child with taxable income that can be offset by the various college tuition credits that are available under tax law. The opportunity exists only if the child is eligible to claim themselves as a dependent or if the parent is eligible to claim the child but forgoes the dependency exemption.

**Take advantage of tax credits.** There are many federal tax credits available to a taxpayer. There are also many credits that the State of Wisconsin offers for businesses that expand and create jobs in Wisconsin. The Wisconsin Economic Development Corporation administers certain taxpayer credits. It is important to evaluate the actual benefits of any potential credits. Things like the Alternative Minimum Tax (AMT) and other circumstances may limit the benefit of tax credits.

**Impact of Health Care Reform.** One of the most highly publicized provisions of health care reform began January 1, 2015. Employers with 100 or more full-time (30 hours a week or more) equivalent employees are subject to penalties if they do not offer affordable health insurance to their full-time employees. Employers with 50 to 99 full-time equivalent employees have a delay on the penalty provisions which will start January 1, 2016.

Information reporting mandated by health care reform starts January 2016 for the 2015 calendar year, regardless of taxable year or plan year. Large employers, those with at least 50 full time equivalent employees, and any employer that has a self-insured health plan must report certain information to the IRS. This information will be used by the IRS to compute the employer penalty (the penalty is not self-assessed) and to help the IRS determine which individual taxpayers may be subject to an individual mandate penalty or eligible for a subsidy when purchasing health insurance through the marketplace. The information will be reported on Form 1095-C to the employee and Form 1094-C as a transmittal to the IRS. Form 1095-C is due by the end of January for the employee and end of February to the IRS for paper filing and end of March if submitting via eFiling.

## Ideas for individuals

Other than tax brackets increased for inflation, the same tax rates and taxes from 2014 apply in 2015. The table below shows where the top tax rate of 39.6% starts. As you can also see, this is where the 20% capital gains and dividend rates kick in. The benefits of itemized deductions and personal exemptions start to phase out when Adjusted Gross Income (AGI) exceeds certain thresholds.

<table>
<thead>
<tr>
<th>Marital Status</th>
<th>Start of 39.6% tax bracket and 20% dividend and capital gain tax rate. Taxable income of:</th>
<th>Start of phase-out of itemized deductions and personal exemptions. AGI of:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Married filing jointly and surviving spouse</td>
<td>$464,850</td>
<td>$309,900</td>
</tr>
<tr>
<td>Head of household</td>
<td>$439,000</td>
<td>$284,050</td>
</tr>
<tr>
<td>Single</td>
<td>$413,200</td>
<td>$258,250</td>
</tr>
<tr>
<td>Married filing separately</td>
<td>$232,425</td>
<td>$154,950</td>
</tr>
</tbody>
</table>

In addition to the income tax, there are two Medicare taxes created by health care reform. First, there is an additional 0.9% Medicare tax on wages and self-employment earnings that exceed $200,000 for a single taxpayer/head of household and $250,000 for a married filing joint taxpayer. Second, a 3.8% Medicare tax applies to net investment income (interest, dividends, royalties, rents, gains and passive income, less certain deductions allocated to investment income) when modified AGI exceeds $200,000 single/head of household and $250,000 for married taxpayers. Both Medicare taxes have a large marriage penalty. The AGI threshold amounts are not indexed for inflation so it is possible more taxpayers will creep into the new taxes each year. Interestingly, while a child might be subject to the Kiddie tax where the child pays tax at the parents’ income tax bracket, there is no Kiddie tax concept when it comes to the 3.8% Medicare tax on net investment income.

## Ideas for maximizing nonbusiness deductions

**Make charitable gifts of appreciated stock.** If you have appreciated stock that you’ve held more than a year and you plan to make significant charitable contributions before year-end, keep your cash and donate the stock (or mutual fund shares) instead. You’ll avoid paying tax on the appreciation, but will still be able to deduct the donated property’s full value. If you want to maintain a position in the donated securities, you can immediately buy back a like number of shares.
However, if the stock is now worth less than when you acquired it, sell the stock, take the loss and then give the cash to the charity. If you sell the stock at a loss, you can’t immediately buy it back as this will trigger the wash sale rules, which means your loss won’t be deductible, but instead will be added to the basis in the new shares. If you instead donate the stock to the charity, your charitable deduction will equal the stock’s current depressed value and no capital loss will be available.

**Don’t lose a charitable deduction for lack of paperwork.** Charitable contributions are only deductible if you have proper documentation. For cash contributions of less than $250, this means having either a bank record that supports the donation (such as a cancelled check or credit card receipt) or a written statement from the charity that meets tax law requirements. For cash donations of $250 or more, a bank record is not enough. You must obtain, by the time your tax return is filed, a charity-provided statement that shows the amount of donation and lists any significant goods or services received in return for the donation or states that you did not receive any goods or services from the charity. If you do not have the required statement from the charity, the IRS will disallow the deduction. Donations of property, other than publicly traded stock, require an appraisal if the value is more than $5,000.

**Donate an IRA withdrawal directly to charity.** While this provision is currently not in tax law for 2015, it is possible this provision will get extended by Congress. When Congress extended this law in prior years, they allowed those who made a contribution of IRA money late in the year as eligible for this provision. Therefore, holding off as long as possible to make a donation of IRA funds might allow you to treat the income as non-taxable if history repeats itself.

### Effective tax planning for investments and making the most of year-end securities transactions

As stated earlier, the 2015 tax rates increased from 2014 only for inflation. For taxpayers whose taxable income exceeds the amounts shown above, the dividend and capital gain rate is 20%. In addition, the 3.8% Medicare tax on net investment income kicks in at the AGI amounts shown previously. If you have enough income to be subject to the higher rate and additional Medicare tax, investment tax strategies are very important.

**Consider selling loss stocks to offset any capital gains.** If it makes investment sense, consider selling loss stocks to offset any capital gains recognized earlier this year. Plus, you can sell enough to generate another $3,000 in losses ($1,500 for married filing separate status), which can then be deducted against your income from all other sources. Because selling the losers reduces your income, this may mean you will be eligible for other tax breaks that are based on AGI, like the college credits, etc.

If your year-to-date sales have resulted in an overall loss in excess of $3,000, you can sell enough stocks with gains between now and year-end to get back to the “negative $3,000” level. Cashing in gains to that extent won’t add a cent to your federal tax bill, whether or not the assets have been held over 12 months. On the other hand, if your year-to-date sales are currently standing at zero or a net gain and you want to unload some winners but no more losers before year-end, try to sell only those you’ve owned for more than 12 months. Then, the resulting gains will be long-term gains and taxed at the 0%, 15% or 20% tax rate, depending on your taxable income.

When selling stock or mutual fund shares, the general rule is that the shares you acquired first are the ones you sell first. However, if you choose, you can specifically identify the shares you’re selling when you sell less than your entire holding of a stock or mutual fund. By notifying your broker of the shares you want sold at the time of the sale, your gain or loss from the sale is based on the identified shares. This sales strategy gives you better control over the amount of your gain or loss and whether it’s long- or short-term.

**Planning opportunities for installment sales.** Installment sales have lots of planning opportunities. If you enter into an installment sale in 2015, consider current and future tax rates. Reporting gain for an installment sale in the year you collect payment on the sale is typically the way to minimize taxes. However, it may make sense to elect out of installment sale treatment and to instead report the entire gain in 2015. The decision depends on what you think your future tax rate will be.
will be and the impact on AGI of using or electing out of the installment sale method. Of course, you also have to consider the time value of money, paying tax later vs. sooner. Not only do you have to consider what income tax bracket you will be in, you need to consider the impact of the 3.8% Medicare tax on net investment income and the impact on AGI. **Review your investment strategy.** It may also be worthwhile to reconsider the after-tax rate of return on investments that pay dividends, municipal income, taxable interest, etc. Any taxable interest, dividend or capital gain is subject to income tax and potentially the 3.8% Medicare tax on net investment income. The after-tax rate of return has automatically gone down on your investments if you are subject to the higher tax rates and the Medicare tax. Investing for growth vs. current income or generating municipal income may be a way to defer or eliminate taxes on your investment income.

Remember, tax planning strategies should only be implemented if they also make sense from an investment and economic standpoint. In other words, saving tax dollars should not be the primary consideration when making investment decisions.

**Health insurance coverage and Health Savings Accounts (HSAs)**

**Review your health insurance coverage.** If you and your family don’t have adequate medical insurance (referred to as minimum essential coverage), you could be subject to a penalty. Medical insurance provided by your employer or through an individual plan purchased through a state insurance marketplace generally qualifies for adequate coverage. The penalty is based on the number of uninsured members of your household and your household income. For example, if you have three or more uninsured household members, the penalty could be $975 or more for 2015 ($2,085 or more for 2016), depending on your household income.

**Consider a Health Savings Account (HSA).** If you are enrolled in a high-deductible health insurance plan and don’t have any other coverage, you may be eligible to make pre-tax or tax-deductible contributions to an HSA. The 2015 limits are $6,650 for family coverage and $3,350 for individual coverage. Distributions from the HSA are tax free as long as the funds are used to pay unreimbursed qualified medical expenses. Amounts remaining in the HSA at the end of the year can be carried over indefinitely.

**Ideas for the office**

**Maximize contributions to 401(k) plans.** Contribute as much as you can, especially if your employer makes matching contributions. You give up “free money” when you fail to participate to the max for the match. If your employer offers a Roth 401(k) feature, consider if deferring into a Roth 401(k) would be beneficial. Maximizing your pre-tax contributions reduces your AGI and thus may keep you in a lower tax bracket or allow you to claim certain tax breaks. Distributions from 401(k) plans (and IRA accounts) are not considered investment income and not subject to the 3.8% Medicare tax on net investment income.

**Take advantage of flexible spending accounts (FSAs).** If your company has a health care and/or dependent care FSA, before year-end you must specify how much of your 2016 salary to convert into tax-free contributions to the plan. You can then take tax-free withdrawals next year to reimburse yourself for out-of-pocket medical and dental expenses and qualifying dependent care costs. Watch out, though, FSAs are “use-it-or-lose-it” accounts—you don’t want to set aside more than what you’ll likely have in qualifying expenses for the year. A health care flexible spending account has an annual $2,550 deferral limit.

**Adjust your federal income tax withholding.** If it looks like you are going to owe income taxes for 2015, consider bumping up the federal income taxes withheld from your paychecks now through the end of the year. When you file your return, you will still have to pay any taxes due less the amount paid in. However, as long as your total tax payments (estimated payments plus withholdings) equal at least 90% of your 2015 liability or, if smaller, 100% of your 2014 liability (110% if your 2014 AGI exceeded $150,000; $75,000 for married individuals who filed separate returns), penalties will be minimized, if not eliminated.

**IRAs—Roth and traditional**

**Roth IRAs.** For many taxpayers, Roth IRAs are a significant tax planning opportunity and are potentially more beneficial than traditional IRAs or other retirement plans. One significant advantage of Roth IRAs is that minimum distributions never need to be taken. Another benefit is that distributions are not taxable if certain holding periods are met. Therefore, money contributed today to a Roth IRA can grow tax free for your lifetime and beyond. The power of tax-free compounding for many years is substantial.

**Conversions of traditional IRA to Roth IRA.** Under current tax law, any taxpayer can convert a traditional IRA account to a Roth IRA account. The amount converted creates taxable income to the extent IRA contributions were deductible. Any earnings on the account are taxable. The income generated by a Roth conversion is not subject to the 3.8% Medicare tax on net investment income. But the income does increase your AGI and will impact all the items that are based on AGI.

If you did a conversion to a Roth IRA earlier in the year, you
can “undo” (recharacterize) some or all of the Roth conversion back to a traditional IRA by the due date of your 2015 return, including extensions, and then reconverit it to a Roth IRA. It would be wise to consider this if the IRA account has dropped in value since being originally converted. There are time constraints that must be followed if you do this. This rule basically allows you to pick exactly the amount of conversion you would like to pay tax on.

The decision to convert a traditional IRA account to a Roth IRA account is complex, and based on several factors—your tax bracket now and in the future, how long the account can grow, future cash needs, the ability to pay the income tax on conversion from outside the IRA, and estate planning objectives.

**IRA contributions.** Don’t forget to make your 2015 traditional or Roth IRA contributions before the due date (April 18, 2016) of your 2015 tax return. For 2015, combined Roth and traditional IRA contributions generally can be made up to the lesser of (1) $5,500 ($6,500 if age 50 or older by the end of 2015) or (2) 100% of compensation. Compensation includes wages, salaries, other amounts derived from or received for personal services actually rendered including self-employment income, and alimony. For married couples, IRA contributions up to $5,500 ($6,500 if age 50 or older by the end of 2015) can be made for each spouse if the combined compensation of both spouses is at least equal to the contributed amount and they file a joint return.

If neither you nor your spouse is an active participant in certain retirement plans, traditional IRA contributions are fully deductible. Otherwise, the amount of the traditional IRA contribution that is deductible will be limited when your AGI exceeds certain limits.

Roth IRA contributions are never deductible. Unfortunately, Roth IRA contributions are not allowed when your 2015 AGI exceeds $193,000 if you’re married and file jointly or $131,000 if you’re not married.

If you have earned income, but don’t qualify to make a Roth IRA contribution or a deductible traditional IRA contribution, you may still want to make a nondeductible contribution to a traditional IRA to take advantage of the tax deferred growth such accounts provide. Making nondeductible contributions might also make sense as they will allow you to take advantage of a Roth IRA conversion (discussed earlier).

Don’t overlook estate planning or gifting

Don’t forget about estate planning and gifting. Trusts might need income tax planning too!

We currently have a very generous lifetime exemption of $5,430,000 for 2015. The estate and gift tax rate is currently 40%. The 2015 annual gifting limit is $14,000. Because of the generous amount of the unified credit, many taxpayers will not have a taxable estate. However, that does not mean estate planning is not necessary. There are still a variety of reasons to occasionally review your estate plan.

**Trusts.** Trusts are subject to the 3.8% Medicare tax on net investment income when the trust’s taxable income exceeds $12,300, to the extent the trust has not distributed its net investment income. If the income beneficiaries of a trust are not subject to the 3.8% Medicare tax on net investment income, but the trust is subject to the tax, making a distribution to the beneficiaries may eliminate the tax at the trust level. The good news is that a distribution can be made 65 days after the year-end and be effective for the prior tax year. This allows planning to happen after the fact.

**Conclusion**

Through careful planning, it’s possible your 2015 and 2016 tax liability can still be significantly reduced, but don’t delay. The longer you wait, the less likely it is that you’ll be able to achieve a meaningful reduction. The ideas discussed in this letter are a good way to get you started with year-end planning, but they’re no substitute for personalized professional assistance. Please call us with any comments or questions that you may have.

Sincerely,

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