Feature Articles

Highlights of Pertinent 2016 Tax Code Changes

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As we all know, preparing a tax return is not merely entering a few figures on various schedules and allowing the software to compute the resulting liability.

Instead, the tax prep process involves the proper application of ever-changing regulations, seeking the most favorable treatment of income and expenses to ensure that a taxpayer pays the least amount of tax legally allowable, and that the tax return can withstand the scrutiny of an examiner if selected for audit. To accomplish the task, I spend endless hours familiarizing myself with Treasury Regulations and Revenue Procedures, identifying non-conforming state rules, seeking out tax minimization strategies for low- and high-income earners, culling the mass of information, and finally presenting the most salient points in a usable and understandable format.

Filing Deadlines: The IRS will begin accepting e-filed returns on January 23rd; California's tax season was officially opened January 4th. This year's federal filing deadline will be **Tuesday, April 18th** since Emancipation Day, the anniversary of the abolition of slavery, will be celebrated in D.C. on Monday, April 17th. Normally the holiday is observed on April 16th but because that's a Sunday this year, the holiday has been shifted to the Monday after. And while state and local holidays are not usually honored by the federal government, the IRS nevertheless considers *this* one a federal holiday for tax-filing purposes. With offices closed on Monday, the tax filing day is then automatically shifted to the next business day; in this case Tuesday. Most states, including California, have opted to conform to the federal due date.

New due dates! As per the Surface Transportation and Veterans Health Care Choice Improvement Act, the following due dates for 2016 tax returns now apply:

Form (TY2016)	Due Date (2017) *if fiscal, not calendar year used	Extended Due Date (2017)
1040 (Individual Return)	18-Apr	16-Oct
1065 (Partnership Return)	March 15*	September 15*
1120-S (S-Corp. Return)	March 15*	September 15*
1120 (Corp. Return)	April 18*	September 15*
1041 (Fiduciary Return)	April 18*	October 2*
990 (Non-profit Organization)	May 15*	November 15*

Foreign Account Reporting: *Taxpayers who had authority over foreign financial accounts with a combined value in excess of $10,000 at any time during 2016 must* e-file FinCEN 114 *by **April 18th** which purposely coincides with the income tax filing deadline; taxpayers who fail to comply receive an automatic 6-month extension. Individual taxpayers, as well as corporations and partnerships beginning with the 2016 tax year, may also be required to file Form 8938 and attach it to their income tax return if the aggregate value of foreign financial assets exceeds $50K. **NOTE:** CA now conforms to FATCA reporting requirements: Failure to attach the federal Form 8938 to the state return will result in a $10,000 state penalty in addition to any applicable federal penalties.*

Free Application for Federal Student Aid (FAFSA): *In the past, the online application became available January 1st of each year and was generally required to be filed in the spring of the calendar year in which the student intends to enter college; CA schools, for example, mandated filing on or before March 2nd, 2016 for the school year which began with the Fall 2016 term. However, for the 2017/18 academic year, the application has been available as early as **October 1st, 2016** and applicants have been allowed to use income information from tax returns that have already been filed in an earlier year; thus, students (parents) may* submit 2015 (rather than 2016) tax return information.

Information Returns: In hopes of combating identity theft, the IRS now requires that copies of W-2s issued to employees and 1099s issued to independent contractors be submitted with the accompanying Forms W-3 and 1096 by **January 31st** [in prior years this deadline was February 28th]. Forms 1098 issued by mortgage companies must now include the outstanding loan balance, in addition to the interest paid.

Local Business Tax: Most cities—including the City of Los Angeles – demand that businesses be registered; the attendant tax may sometimes be waived *if* registration forms are timely filed (**February 28th** for Los Angeles). ***NOTE:*** In addition to sole proprietors and partners who clearly operate an ongoing enterprise, independent contractors (workers paid via 1099 rather than W-2) are deemed to be "in business" for licensing purposes. **TIP:** Some localities may require AirBnB and other short-term rental hosts to submit Business Property Statements for the purpose of assessing an annual tax on the value of personal property and fixtures used in the business.

"Permanent" Changes: Protecting Americans from Tax Hikes Act of 2015 (PATH) was enacted in late 2015, making certain Code provisions permanent if, in fact, anything on the Hill could be considered inviolable before the next batch of legislators take control. As a result, taxpayers have been "guaranteed" that the American Opportunity Credit will provide a tax savings of up to $2,500/year for the first 4 years of post-secondary education; that school teachers may claim an above-the-line deduction of as much as $250/year for classroom supplies; that self-employed and business taxpayers may expense (rather than depreciate) up to $500,000/year of newly purchased equipment; that 100% of the gain on sale of §1202 Small Business Stock is excludable; that sales tax may be deducted in lieu of state and local income taxes paid.

Tax Extenders: Some provisions were extended only for another year, others for periods ranging from two to five years. The exclusion of mortgage debt relief was extended through December 2016 [although CA does not conform which means that residents may face a hefty state tax bill even if debt cancellation is exempt from federal taxation!!!]; generous bonus depreciation provisions were extended but will be phased out on a sliding scale between now and 2019; the deduction for qualified tuition expenses and mortgage insurance premiums, as well as energy credits for qualified home improvements, while still valid for the 2016 tax year, have now expired.

Tax Saving Strategies: The following list of suggested tactics may serve to reduce your federal (and sometimes state) tax liability although each strategy may not yield the same result for every taxpayer.

- **Medical Expenses:** Medical insurance premiums are tax-deductible (sometimes). If you are self-employed, you may claim an above-the-line deduction for 100% of the premiums paid, including Medicare premiums withheld from Social Security benefits. Others must file Schedule A and itemize their deductions to obtain a tax benefit; the aggregate of all medical expenses must exceed 10% of Adjusted Gross Income (AGI). Seniors who reached age 65 before year-end 2016 may, this last time, still benefit from the old AGI limit of 7.5%.
- **Qualified Charitable Distribution (QCD):** Seniors over the age of 70½ may elect to make a *direct* IRA-to-charity transfer, thereby avoiding the inclusion of their Required Minimum Distribution (RMD) in taxable income, minimizing the taxability of Social Security benefits, lowering Adjusted Gross Income (AGI) thresholds for various itemized deductions, and potentially avoiding the Medicare Surtaxes.
- **Qualified Longevity Annuity Contract (QLAC):** Available to allow taxpayers to defer the RMD requirement past the age of 70½, although QLAC distributions must begin no later than age 85. This fixed annuity may be funded with 25% of the taxpayer's IRA up to $125,000 and guarantees a lifetime income stream which may be passed to spousal and other beneficiaries in the event that the plan owner dies before the contract payouts have been fully distributed.
- ***College Access Tax Credit (CATC):** A 50% credit against California state taxes for amounts donated to fund Cal Grants for low-income college students. While there is no federal credit, taxpayers may instead claim an itemized deduction on Schedule A.* Online *contributions for 2017 – the final year – may be made beginning **March 2nd**.*
- **Home Office Deduction**: Under the optional safe harbor method, taxpayers may claim a deduction equal to $5/ft^2 (maximum $1,500) in lieu of separately detailing allowable expenses and depreciation presuming, of course, that they have an area in the home that is used *regularly* and *exclusively* for business and that such use is for the *convenience of the employer*.
- **Repair Regulations:** In an attempt to standardize and simplify taxpayer reporting, the IRS introduced new reporting requirements for business and rental property repairs. The general rule now holds that all tangible property purchased for use in a trade or business – except inventory – must be capitalized, except costs for (a) materials and supplies under $200, (b) routine maintenance incurred to keep property in its ordinarily operating condition, (c) de minimis outlays up to $2,500 for which taxpayer makes an affirmative Safe Harbor election, and (d) maintenance and repair of buildings owned by small taxpayers with outlays of less than $10K. If costs are expected to exceed the threshold limits, taxpayers may wish to split multiple projects over two calendar years to avoid the capitalization requirement.
- **Residential Energy Efficient Property Credit:** You may qualify for a non-refundable credit equal to 30% of your total cost if you install certain alternative energy equipment in your home, including solar-powered units that generate electricity or heat water. The full credit is available through the end of 2019, then decreases annually to zero after 2021, and is available only for improvements made to your primary or second residence but not rental properties. ***NOTE:*** Leased solar panels and new roofing costs are ineligible for the credit; and if the purchase is financed through a program that allows repayment via property taxes, the allocated portion of such taxes is non-deductible.

Affordable Care Act (ACA): Although the new Congress has threatened to repeal and replace the existing healthcare mandate, nothing concrete has yet been proposed and so "Trumpcare", at least for the moment, remains an enigma. While things are sure to change – maybe even retroactively to the beginning of 2017 – the provisions of the ACA as previously enacted remain in effect for the 2016 tax year. Therefore, affected taxpayers should be aware that they may be subject to *two* separate penalties:

- **Shared Responsibility Payment:** All individuals and their family members are required to have medical insurance; which must be verified and reported on the taxpayer's income tax return. If you obtained coverage through the Health Insurance Marketplace, you will receive Form 1095-A documenting coverage maintained during each month of the prior year (2016). If you purchased insurance directly from an insurance company, you will receive Form 1095-B; if you were insured through an employer plan, you will receive Form 1095-C. These forms must be provided to you on or before **March 2nd**. Since verification of Minimum Essential Coverage is crucial, the filing of your tax return may have to be postponed until Form 1095 is received, even if all remaining data is otherwise available. In 2016, failure to obtain coverage may cost you a penalty equal to the greater of $695/adult ($347.50/child) or 2.5% of your yearly household income, limited to a family maximum of $2,085. You can use this calculator to estimate your penalty.
- **Repayment of Premium Tax Credit**: Some taxpayers may be required to refund advance credits received during 2016 to subsidize the cost of monthly premiums for insurance obtained through the Marketplace if actual income reported on the tax return exceeds the amount of income used to determine the premium credit when the insurance was purchased. ***NOTE:*** Even taxpayers who otherwise have no filing requirement must file a tax return to reconcile the advance credit.

As part of the ACA, two surtaxes are levied against high-income earners. Although the fate of these taxes now lies in the balance, they are currently in effect:

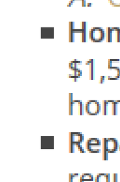
- **Medicare Surtax:** Wage-earners and self-employed taxpayers with incomes in excess of $200K ($250K if married) are subject to an additional 0.9% FICA tax. **TIP:** Payroll withholding allowances and/or quarterly estimates should be adjusted to cover the additional liability as taxpayers can otherwise be hit with underpayment penalties.
- **Net Investment Income (NII):** Investment income – including dividends, interest, net capital gains, annuities, royalties and net rents, as well as the gain on sale of a principal residence in excess of the allowable §121 exclusion – greater than $200K ($250K if married) is subject to a Medicare surtax of 3.8%. Income from tax-exempt interest, VA benefits, self-employed income, IRA and pension distributions is not subject to this surtax.

Collection Issues: In its efforts to increase collections and pursue scofflaws, Congress has enacted various provisions. Let's hope that these do *not* affect YOU!

- **Private Debt Collectors:** For the third time, Congress has mandated that the IRS use private debt collectors for delinquent tax debts. Both previous attempts – in 1996 and 2006-2009 – were scrapped as failures; nevertheless a new attempt will begin this spring. The IRS will give each taxpayer written notice that the account is being transferred to a private collection agency which will then send a second, separate letter to the taxpayer confirming the transfer. Private agencies may not ask for payment on a prepaid debit card. Instead, taxpayers will be given the option to submit a check payable to the US Treasury or make electronic payments directly to the IRS.
- **Travel Restrictions:** The Fixing America's Surface Transportation Act of 2015 (FAST) grants the IRS the ability to notify the US State Department of taxpayers with "seriously delinquent" tax debts, defined as unpaid federal taxes over $50,000 (including penalties and interest) for which the IRS has filed a tax lien notice or issued a levy/garnishment. The State Department may then revoke that individual's passport. ***NOTE:*** A debt is not considered "seriously delinquent" if an individual is making payments to the IRS under an approved payment plan or offer-in-compromise, or if the taxpayer is challenging the tax debt with the IRS through "collection due process" proceedings.

Miscellaneous: Finally, here are a few issues – though only relevant to select clients – which are important to note:

- **Individual Taxpayer Identification Numbers (ITINs):** ITINs are used by people who have tax-filing or payment obligations under US law but are not eligible for a Social Security Number. Any ITIN not used on a tax return at least once in the past three years and any ITIN with middle digits of either 78 or 79 expired automatically on January 1, 2017. To avoid return processing and refund delays, as well as denial of some tax benefits, affected taxpayers should renew their expired ITINs as soon as possible. ***NOTE:*** Taxpayers living abroad will discover to their dismay that they may no longer submit their documents to Certifying Acceptance Agents outside of the US, but must now correspond with the IRS Service Center in Austin, TX or visit US-based Taxpayer Assistance Centers.
- **Crowdfunding:** Revenues generated via GoFundMe, Kickstarter and similar web-based platforms are generally considered to be taxable income unless the proceeds represent loan re-payments, capital contributions in exchange for an equity interest in a business entity, or gifts made from "detached generosity" such as those made to help support individuals in need of cancer treatment or victims of a natural disaster. If a campaign creator is seeking to raise funds to develop or market a new product and offers a "reward" in exchange for a contribution, the creator may incur a sales tax liability in all states in which he has a physical presence. ***NOTE:*** Some states deem that a nexus is established simply by clicking on a web-link.



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For additional information, published articles and loads of useful tax information, please head for Monica's website at www.mhaven.net including

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