Rowbotham INTERNATIONAL

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2015 Year-End Tax Planning Checklist

It's once again time to review tax planning ideas. Transactions and revenue recognition can often have significantly different tax outcomes depending on the timing. The following tax planning should be considered prior to year end.

1. **Change Timing on Income and Deductions:** Depending on your 2015 and 2016 taxable income, consider deferring or accelerating income and deductions to reduce your overall tax. A cash basis taxpayer can often prepay expenses related to the next year as long as the accelerated deduction does not distort income.

2. **Alternative Minimum Tax:** If you have significant capital gains or large deductions in relation to your total income for 2015, you will likely be subject to alternative minimum tax at 28% or 26%. In this case, deductions such as state and local income tax, property taxes, and miscellaneous itemized deductions will not provide a tax benefit. Consider deferring payment of such expenses until next year.

3. **Charitable Deductions:**
    a. Consider giving appreciated property. The full value of donated property is generally tax deductible. This will save both income tax and the additional 3.8% tax on net investment income.
    b. Credit card donations made by the end of the year are deductible for 2015, even if you don't pay your credit card bill until next year.
    c. Gifting your car to a charity? The math may not work out. Typically, the charity will dispose of your vehicle through an auction process. Only the amount paid by the auction buyer is deductible. Due to the significant discounting that occurs in such an auction process, you may be better off selling your car privately, and giving the cash to charity. The extra hassle will probably pay off in more money for the charity and a higher deduction for you.

4. **Cure Tax Underpayments:** Estimated taxes are due quarterly if your wage withholding is not sufficient to cover at least 90% of the tax due. If you are underpaid on your estimated tax, consider increasing your withholding tax prior to the year-end. Withholding tax is considered to be paid ratably throughout the year and can cure earlier year deficiencies.

5. **Gifting:** Each year, one can give away $14,000 per donee. Parents with two children can, thus, give away $28,000 in cash or value to each child without any reporting. In addition, U.S. citizens and residents have a lifetime exemption of $5,340,000 (2015). For 2016, the lifetime exemption amount increases to $5,450,000. Gifts that exceed the annual and lifetime exemption are taxed at 40%. If you have highly appreciating assets, consider making gifts this year before appreciation reduces the potential value you can shift to other family members.

6. **GRAT (Grantor Retained Annuity Trust):** If your wealth exceeds $5,340,000 (2015) or $5,450,000 (2016) and your assets continue to increase, consider establishing a GRAT. A GRAT is an additional tool available to make large gifts, often tax-free, of future appreciation.

7. **IRA Contributions:** Consider maximizing IRA deductions from wages, especially if your employer has a matching contribution plan. There are special catch up provisions for individuals over age 50 that allow for increased contributions.

8. **Convert to a Roth IRA:** IRA earnings are deductible when funded but are fully taxed when distributions are made. By "Rotherizing" one's IRA (a taxable rollover of one's IRA balance into a new Roth IRA), future earnings and growth will be tax exempt when earned *and* when distributed. Additionally, investors should consider this option when they invest in new startups that have potential for huge payouts.

9. **Employer Benefits:** Check into employer benefits (*e.g.* Health Savings Account) to be sure you are taking full advantage of opportunities.

10. **Capture Losses:** Consider selling stocks with built in losses to offset realized gains. If you still wish to hold the stock, it can be repurchased after 30 days, and the losses will still be allowed as deductions.

11. **Qualified Small Business Stock (QSBS):** Small business stock purchased on or after January 1, 2015 and held for more than five years will be eligible for a 50% exclusion.

12. **Installment Sale:** Consider selling assets on the installment basis, and defer the cash receipt until 2016. If the actual transaction occurs this year, one has until the extended due date of one's 2015 tax return to decide whether to defer the gain or accelerate the gain into 2015. Hindsight is 20-20!

13. **Options:** Stock options should be exercised early when stock values are very low making all future appreciation long-term capital gain instead of ordinary income.

14. **Investment Interest Expense:** Taxpayers may deduct their home mortgage interest on acquisition indebtedness up to $1mm, plus $100,000 of home equity debt. Thereafter, the debt is personal and is nondeductible. High net worth investors will often access their home equity due to low interest rates and good investment returns. In this situation, the home-owner can consider the following:

    a. Acquire the home with $1mm of mortgage and the balance in cash.

    b. After closing, refinance the equity from the home and transfer the cash into an investment account.

    c. The interest paid to the bank on the refinancing should be lower than typical debt, due to the home being used for securing the loan, and the interest should qualify as investment interest due to tracing rules.

    d. This converts otherwise nondeductible mortgage interest into qualified investment interest expense.

15. **Active Real Estate Professional:** There are material participation rules that need to be met for taxpayers with high real estate losses on properties that wish to use the full losses. If the minimum of 750 hours per year is not met, the taxpayer may lose their status regarding their classification as a real estate professional. If this occurs, they will then be subject to significant limitations on the amount of current losses from real estate that can be used to offset other income.

16. **New Deadlines for 2016:** The "Surface Transportation and Veterans Health Care Choice Improvement Act of 2015" changed a lot of tax filing deadlines:

    <u>Foreign Bank Account Reporting (FBAR)</u>

    FBARs will now be due on April 15, and can be extended to October 15. The automatic extension to June 15 for residents outside the U.S. does not apply. In addition, first time failure to file are now excused without penalty.

Partnerships

Partnership tax returns will now be due March 15, and can be extended to September 15.

C corporations

Corporate tax returns for C corporations will now be due April 15, and can be extended to September 15.

S corporations

There is no change for corporate tax returns for S corporations. They are still due March 15, and can be extended to September 15.

All the new deadlines apply for the 2016 tax year, and future years. For 2015, all tax filings are due according to the old deadlines.

Business Planning

1. Review Accounting Methods — Changes in accounting methods can provide significant savings.
    a. Review whether cash or accrual method is the best approach for your business.
    b. Recurring items: in some instances, accrual based companies can elect to deduct recurring expenses, paid by the end of the year, but related (*i.e.* incurred) in 2016.
2. A business can claim a cash basis contribution to its profit sharing plan as a deduction in 2015, even if the contribution is not funded until the following year as long as the plan is in place by the end of this year.
3. Consider business alternatives as a C or S corporation vs. LLC. For service related businesses, high income earning owners should know that S corporations do not impose a 3.8% tax on net investment income. The S corporation might also eliminate this tax on the sale of property. For example, the sale of a rental property owned directly or through an LLC will be subject to the net investment income tax compared to the same sale through an S corporation where such tax does not apply.

With respect to new tax rates and adjustments for 2016 due to inflation.

Pre-Arrival Planning – Foreign Nationals

Our firm advises foreign investors and incoming foreign nationals on a multitude of pre-arrival planning issues and opportunities. The following is a pre-arrival tax planning checklist of issues to consider.

1. Consider establishing a foreign or U.S. trust for estate planning purposes. If assets are located in one's country of origin, it may be necessary to consult with local counsel to coordinate legal and tax issues. The use of trusts may not work in civil law jurisdictions, e.g. France and Germany.
2. Determine if accelerating gift planning or contemplated sales of assets prior to entering the U.S. will save global tax. A foreign person wishing to make a gift of U.S. property is only allowed a $14,000 annual exclusion; a gift of foreign property is entirely exempt. Additionally, a sale of assets by a foreign person is often exempt from U.S. tax.
3. Explore tax strategies that will step up the tax basis of assets to their fair market value so only appreciation after becoming a U.S. resident will be taxable in the U.S.

4. Review existing investment structures to determine whether there will be adverse tax impact under U.S. tax laws.

5. Stock options, when exercised, usually generate ordinary income in the U.S. that is taxable at the top rate of 39.6%. Consider exercising options prior to arrival.

6. Review deferred compensation and retirement benefits to determine how to efficiently access income with minimum tax before and after arrival.

7. Foreign stock plan: Check whether vesting will be taxable after entering the U.S. 83(b) election time may have expired.

8. If you are being relocated to the U.S., consider whether you should be employed by the U.S. or foreign affiliate and whether you should be covered by social security in the U.S. or in your home country.

9. If you are in the U.S. for less than 183 days in the year, you may be exempt from U.S. tax under the relevant income tax treaty.

10. Transfer appreciated assets to a foreign trust or foreign company prior to arrival to avoid triggering tax on the appreciation.

11. Expatriation: If after 7 years of residence as a green card holder, you relinquish your green card and leave the U.S., you may be subject to an exit tax on appreciated assets. To minimize this risk, you may wish to defer obtaining your green card if your stay in the U.S. is not permanent.

12. Reporting bank balances and foreign investments is required of U.S. residents and citizens under federal and state rules. The following IRS forms need to be filed:

    - FinCEN 114 Foreign Bank Account Report – For balances in excess of $10,000
    - Form 3520 Receipt of any distributions or benefits from a foreign trust
    - Form 3520 Receipt of gifts or bequests over $100,000 from a foreign person
    - Form 3520A Annual return for a foreign trust
    - Form 5471 Return of U.S. person in certain foreign corporations
    - Form 8865 Return of U.S. person in certain foreign partnerships
    - Form 8621 Investment in a passive foreign investment company (e.g. foreign mutual fund)
    - Form 8938 Statement of foreign financial assets

    Caution: Many foreign holding structures may fall within these reporting requirements. Significant penalties apply if these disclosures are not made.

If you have any questions, contact

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