The Norton Tax Bulletin

Richard E. Norton, E.A., Tax Resolution Specialist
513 North Florence Street, Burbank, California 91505
(818) 842-5927 Fax: (818) 845-6031 E-mail: dick@dicknorton.com

October 12, 2015

Recent Tax Developments

Dear Clients, family and friends,

The following is a summary of important tax developments that have occurred in the past three months that may affect you, your family, your investments, and your livelihood.

Before getting into the new material, the extended filing deadline for 2014 is just three (3) days away! Hopefully, all of you have filed your returns by now. If not, you have a short (very short….) window of opportunity to do so. Taxpayers who are on alternative payment plans or have a granted offer in compromise (OIC) that is less than 5 years old have a mandate to timely file – or they suffer harsh consequences.

OK – here are some important items:

New tax legislation. On July 31, 2015, President Obama signed into law the **"Surface Transportation and Veterans Health Care Choice Improvement Act of 2015"** (the Transportation Act), which extended the Highway Trust Fund and included a number of important tax changes.

The most important tax changes in the Transportation Act are those that adjust tax-filing deadlines for partnerships and C corporations. Specifically, for tax years beginning after Dec. 31, 2015 (*for calendar year taxpayers, that means the 2016 tax returns – due over a year from now*):

- Partnerships and S corporations must file their returns by the 15th day of the third month[1] after the end of the tax year. Thus, most all partnerships will now have to file by **March 15th.** Thus, the filing deadline for partnerships will be accelerated by one month but the filing deadline for S corporations will stay the same.
- C corporations get a bit of a break by now having to file by the 15th day of the fourth month[2] after the end of the tax year. Thus, beginning with the 2016 tax year, C corporations using a calendar year must file by Apr. 15 (versus March 15th) of the following year. Thus, the filing deadline for C corporations will be deferred for one month. Under a special rule for C corporations with fiscal years ending on June 30, the change won't apply until tax years beginning after Dec. 31, 2025 (*no clue why Congress delayed the implementation date for almost a decade!).*

Due dates for extensions have been adjusted as well, effective generally for returns for tax years beginning after Dec. 31, 2015. For example, the new law creates the following exceptions to the 6-

[1] Previously, partnership returns were due the same time as the Federal 1040 – the 15th day of the 4th month! Now, they will share the same deadline as the 1120S. Filing these returns late will result in expensive late filing penalties.

[2] Corporations historically had to be filed by the 15th day of the third month following the close of their taxable year. Calendar year-end corporations will now have an extra month to get these returns filed. Fiscal year ending corporations have a LONG time before they get this benefit.

month extension that generally applies to corporations: 1) For any return for a tax year of a C corporation which ends on December 31 and begins before Jan. 1, 2026, the automatic extension period is 5 months. 2) For any tax year of a C corporation which ends on June 30 and begins before Jan. 1, 2026, the automatic extension period is 7 months. And, the maximum extension for the returns of partnerships filing Form 1065 will be a 6-month period (ending on Sept. 15 for calendar year taxpayers) (not 5 months).

Other tax changes included in the Transportation Act include the following:

- Veterans with VA or TRICARE health care coverage aren't counted for purposes of the 50-full-time-employee threshold used to determine if an employer is subject to the Affordable Care Act employer shared responsibility penalty. This change is retroactively effective for months beginning after Dec. 31, 2013.
- Effective for months beginning after Dec. 31, 2015, otherwise eligible veterans are not disqualified from contributing to health savings accounts (HSAs) on a pre-tax basis merely because they receive medical care under any laws administered by the VA for a service-connected disability.
- Effective for returns required to be made and statements required to be furnished after Dec. 31, 2016, lenders must report more information on mortgages, including the origination date, the amount of outstanding principal, and the property's address[3].
- The 6-year statute of limitations applies in cases where any overstatement of basis results in a substantial (25% or more) omission of income. In the past, there had to be an actual non-reporting of additional income. Overstated deductions were never taken into account. This law made an important change which can result in the IRS having a longer period within which to audit a taxpayer's return if they messed up on the calculation of basis for sold property and underreported the taxable gain.
- Effective for property with respect to which an estate tax return is filed after July 31, 2015, large estates (*i.e., those required to file a federal estate tax return*) are required to provide the IRS with the value of property included in the gross estate, to ensure consistent reporting for income and estate tax purposes. Beneficiaries who receive property from a decedent get a "stepped up basis" to the fair market value (FMV) as of the date of the decedent's death. All this change requires is a statement that shows the FMV on the date of death that now has to be filed with the Form 706. The preparer of the return should provide the beneficiary receiving the inherited property with the value used by the Estate.

Home mortgage interest deduction doubled for unmarried co-owners.

The Ninth Circuit Court of Appeals, reversing a Tax Court decision, concluded that the tax law's limits on the amount of debt eligible for the home mortgage interest deduction ($1 million of mortgage "acquisition" debt and $100,000 of home equity debt) are applied on a per-individual basis, and not a per-residence basis as the IRS has long maintained. Thus, for the unmarried co-owners in the case, their collective limit for the home mortgage interest deduction doubled from a maximum of $1.1 million to a maximum of $2.2 million acquisition and home equity debt.

[3] This change likely was made to identify taxpayers who have refinanced their homes and would be limited in the deduction of interest payments – as well as be subject to Alternative Minimum Tax for the non-purchase related part of their mortgage. For taxpayers with loans in excess of one million, the IRS will now be better able to identify taxpayers who have exceeded the loan-balance limitation for mortgage interest deductions.

As a side note, *married taxpayers who file separately* are limited to 50% of the maximum $1.1 million. So, neither spouse can claim the mortgage interest on more than $550,000 of mortgage debt. The only way around this $550,000 limitation is to file a joint return.

Simplified per-diem increase for post-Sept. 30, 2015 travel.

An employer may pay a per-diem amount to an employee on business-travel status instead of reimbursing actual substantiated expenses for away-from-home lodging, meal and incidental expenses (M&IE).If the rate paid doesn't exceed IRS-approved maximums, and the employee provides simplified substantiation, the reimbursement isn't subject to income tax or payroll-tax withholding and isn't reported on the employee's Form W-2. In general, the IRS-approved per-diem maximum is the GSA per-diem rate paid by the federal government to its workers on travel status. This rate varies from locality to locality. Instead of using actual per-diems, employers may use a simplified "high-low" per-diem, under which there is one uniform per-diem rate for all "high-cost" areas within the continental U.S. (CONUS), and another per-diem rate for all other areas within CONUS. The IRS released the "high-low" simplified per-diem rates for post-Sept. 30, 2015, travel. The high-cost area per-diem increases $16 to $275, and the low-cost area per-diem increases $13 to $185.

Folks who do a lot of traveling will want to find out the per diem rates for their travel destinations. The GSA rates are available online – just do a search in Google for “gsa per-diem rates. Be sure to use the correct table that covers the time period of your travel!

New accounting safe haven.

The IRS has provided a new safe harbor that allows accrual method recipients of services to treat economic performance as occurring ratably for contracts where services are provided on a regular basis. Thus, under the safe harbor, a taxpayer can ratably expense the cost of regular and routine services as the services are provided under the contract. The IRS also provided procedures for obtaining the IRS's automatic consent to change to this accounting method, which is effective for tax years ending on or after July 30, 2015. Absent an exception or safe harbor such as this, a liability is generally incurred and taken into account by a taxpayer under an accrual accounting method only in the tax year in which: (1) all the events have occurred that establish the fact of the liability; (2) the amount of the liability can be determined with reasonable accuracy (these first two items are collectively referred to as the all events test); and (3) economic performance has occurred.

As a general rule, service businesses typically use the CASH METHOD[4] of accounting and would not be impacted by this change. Some business – like manufacturers – will use the ACCRUAL METHOD[5] of accounting and if they also provide services to customers, then this change could impact their accounting for income.

Lump sum payments from defined benefit plans.

[4] The CASH METHOD dictates that income is taxable when received (*or available – such as an electronic transfer or deposit*), and expenses are deductible when paid (*that includes a credit card charge – regardless of when the credit card bill is paid*).

[5] The ACCRUAL METHOD of accounting is generally required for businesses that maintain inventories of raw products and finished goods. In these businesses, inventories affect the COST OF GOODS SOLD – and the accrual method of accounting is required to properly reflect income during a tax period or tax year.

The IRS announced that it will change the required minimum distribution (RMD) regs to provide that qualified defined benefit plans generally are not allowed to replace, with a lump sum payment or other accelerated form of distribution, any joint and survivor, single life, or other annuity that is currently being paid. The required distribution rules for pension plan annuities were crafted to provide an administrable way to ensure that a distribution of the employee's benefit will not be unduly tax-deferred. In addition, under the regulations, a defined benefit pension plan cannot permit those currently receiving pension benefits to commute annuity payments to a lump sum or otherwise accelerate those payments, except in a narrow set of circumstances specified in the regulations, such as in the case of retirement, death, or plan termination. If a participant has the ability to accelerate distributions at any time, then the actuarial cost associated with that acceleration right would result in smaller initial benefits, which contravenes the purpose of the required distribution rules. The IRS intends that these amendments to the regulations, with some exceptions, will apply as of July 9, 2015.

Bonus depreciation.

The IRS provided guidance on the retroactive extension of the 50% additional first-year bonus depreciation deduction, and the corporate election to not claim the 50% additional deduction for property placed in service in 2014 and instead increase the alternative minimum tax (AMT) limitation, in light of changes made by the Tax Increase Prevention Act of 2014 (TIPA, P.L. 113-295, 12/19/2014).The additional first-year depreciation deduction is allowed for both regular tax and AMT purposes, but is not allowed for purposes of computing earnings and profits. The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. Most of the guidance is centered on "late" elections to claim or not claim bonus depreciation under TIPA, and on "late" elections by corporations to not claim bonus depreciation in favor of AMT credits.

Residential energy efficient property credit.

The IRS has privately ruled that an individual can claim a residential energy efficient property credit under Code Sec. 25D for the cost of solar panels (*and a partial ownership interest in related equipment*) installed in an off-site community-shared solar project. An individual can claim a 30% credit[6] for qualified solar electric property expenditures made by him during the year. A qualified solar electric property expenditure is an expenditure for property which uses solar energy to generate electricity for use in a dwelling unit located in the U.S. and used as a residence by the

[6] If you install Energy Star-approved solar-power systems before the end of 2016, you can claim 30 percent of the cost as a tax credit *for the year you installed it*. As a credit, you take the amount directly off your tax payment, rather than as a deduction from your taxable income. You can claim the credit for your primary residence, a vacation home, and for either an existing structure or new construction. Other than the cost of the system, there's no limit to the dollar amount of the credit. If a taxpayer ***leases*** (*versus purchases)* the solar equipment, then the credit is not applicable. See below.

To claim the credit, you must file IRS Form 5695 as part of your tax return; you calculate the credit on the form, and then enter the result on your 1040. If you end up with a bigger credit than you have income tax due -- a $3,000 credit on a $2,500 tax bill, for instance -- you can't use the credit to get money back from the IRS. Instead, you can carry the credit over to the following tax year. Energy Star states that you should be able to carry the credit over as far as 2016 if need be.

If you have a solar lease or solar power purchase agreement (PPA) the credit will actually go to the company you're working with, rather than to you. That's because you're not paying for the equipment yourself. However, some companies will pass on the savings to you by offering free installation. You'll get the immediate benefit of a lower cost without having to file any paperwork.

taxpayer. A rental property does NOT QUALIFY!!! This ruling is significant because it is the first one allowing the energy efficient property credit for owners of solar panels in a shared, off site array.

If you have a specific question on the topics included in this letter, or tax law in general, be sure to ask me at your earliest convenience.

Very truly yours,

Dick Norton

> ***This newsletter is not intended or written by me to constitute written advice that you may rely upon to avoid penalties that may be imposed by any taxing authority. A written opinion from a qualified professional addressing your specific circumstances generally would be required as evidence of having relied upon professional advice.***