Anchin Alert

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Accountants and Advisors

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Uncertainty over expired tax provisions complicates year end tax planning

Now that we've entered the final two months of 2014, many businesses and individuals are turning their attention to year end tax planning. This year, however, uncertainty over dozens of expired or expiring tax provisions complicates the planning process, particularly for business owners.

Fifty-seven provisions expired at the end of 2013 and six more are scheduled to expire at the end of 2014. Congress may extend many of these provisions (in some cases retroactively to the beginning of 2014), but that likely won't happen until after the midterm elections on Nov. 4 — and perhaps not for a month or more after that date. In the meantime, there are many year end tax planning strategies for businesses and individuals that are available now. Others won't take shape until after Congress acts.

Keep an eye on expired tax breaks

Year end tax planning for businesses often focuses on acquiring equipment, machinery, vehicles or other qualifying assets to take advantage of enhanced depreciation tax breaks. Unfortunately, the following breaks were among those that expired at the end of 2013:

Enhanced expensing election. Before 2014, Section 179 permitted businesses to immediately deduct, rather than depreciate, up to $500,000 in qualified new or used assets. The deduction was phased out, on a dollar-for-dollar basis, to the extent qualified asset purchases for the year exceeded $2 million. Because Congress failed to extend the enhanced election, these limits have dropped to only $25,000 and $200,000, respectively, for 2014.

Bonus depreciation. Also expiring at the end of 2013, this provision allowed businesses to claim an additional first-year depreciation deduction equal to 50% of qualified asset costs. Bonus depreciation generally was available for new (not used) tangible assets with a recovery period of 20 years or less, as well as for off-the-shelf software. Currently, it's unavailable for 2014 (with limited exceptions).

Lawmakers are considering bills that would restore enhanced expensing and bonus depreciation retroactively to the beginning of 2014, but probably won't take any action until late in the year. In the meantime, how should you handle qualified asset purchases?

1. If you need equipment or other assets to run your business, you should acquire it regardless of the availability of tax breaks.
2. For less urgent asset needs, consider spending up to $25,000, the amount you'll be able to expense regardless of whether Congress extends the expired breaks.
3. For additional planned asset purchases, consider taking a wait-and-see approach and be prepared to act quickly if and when "tax extenders" legislation is signed into law.

Keep in mind that, to take advantage of depreciation tax breaks on your 2014 tax return, you'll need to place assets in service by the end of the year. Paying for them this year isn't enough.

Revisit the research credit
Congress is likely to extend the R&D credit (also commonly referred to as the "research and development" or "research and experimentation" credit), as it has done fifteen times since the credit was first established in 1981. But regardless of whether the research credit is restored, it pays to investigate whether your business since the credit was first established in 1981. But regardless of whether the research credit is restored, it pays to investigate whether your business is eligible for the credit for previous tax years.

Even if you lack the historical base period documentation to support a traditional research credit claim, you may be able to substantiate and qualify your research credit claim utilizing the alternative simplified credit (ASC) regime, as it is substantially more manageable to gather documentation related to the current tax year and the prior three years. Until recently, the ASC could only be claimed on a timely filed original tax return including extensions. But, the IRS issued new regulations in June allowing most eligible businesses to claim missed credits under the ASC methodology for open tax years when filing an amended return.

Don't overlook the manufacturers' deduction
Many businesses miss out on significant tax savings because they fail to recognize that they're eligible for the manufacturers' deduction, also called the "Section 199" or "domestic production activities" deduction. It allows you to deduct up to 9% of your company's income from "qualified production activities," limited to 50% of W-2 wages paid by the taxpayer that are allocable to domestic production gross receipts.

Many business owners assume that the deduction is available only to manufacturers. But it's also available for certain construction, engineering, architecture, software development and agricultural activities.

Consider traditional year end strategies
As always, consider traditional year end planning strategies, such as deferring income to 2015 and accelerating deductions into 2014. If your business uses the cash method of accounting, you may be able to defer income by delaying invoices until late in the year or accelerate deductions by paying certain expenses in advance.

If your business uses the accrual method of accounting, you may be able to defer the tax on certain advance payments you receive this year. You may also be able to deduct year end bonuses accrued in 2014 even if they aren't paid until 2015 (provided they're paid within 2½ months after the end of the tax year).

But deferring income and accelerating deductions isn't the best strategy in all circumstances. If you expect your business's marginal tax rate to be higher next year, you may be better off accelerating income into 2014 and deferring deductions to 2015. This strategy will increase your 2014 tax bill, but it can reduce your overall tax liability for the two-year period.

Finally, consider switching your tax accounting method from accrual to cash or vice versa if your business is eligible and doing so will lower your tax bill.

Implement strategies for individuals
Like businesses, individuals often can reduce their tax bills by deferring income and accelerating deductions. To defer income, for example, you might ask your employer to pay your year end bonus in early 2015. And to accelerate deductions, you might pay certain property taxes early or increase your IRA or qualified retirement plan contributions to the extent that they'll be deductible. Such contributions also provide some planning flexibility because you can make 2014 contributions to IRAs, and certain other retirement plans, after the end of the year.

Remember that, when you use a credit card to pay expenses or make charitable contributions this year, you can deduct them on your 2014 return even if you don't pay your bill until next year.

Other year end tax planning strategies to consider include:

Investment planning. If you've sold stocks or other investments at a gain this year — or plan to do so — consider offsetting those gains by selling some of your poorly performing investments at a loss.

Reducing capital gains is particularly important if you're subject to the net investment income tax (NIIT), which applies to taxpayers with modified adjusted gross income (MAGI) over $200,000 ($250,000 for joint filers). The NIIT is an additional 3.8% tax on the lesser of 1) your net income from capital gains, dividends, taxable interest and certain other sources, or 2) the amount by which your MAGI exceeds the threshold.

In addition to reducing your net investment income by generating capital losses, you may have opportunities to bring your MAGI below the threshold by deferring income or accelerating deductions.

Charitable planning. If you plan to make charitable donations, consider donating highly appreciated stock or other assets rather than cash. This strategy is particularly effective if you own appreciated stock you'd like to sell but you don't have any losses to offset the gains. Donating stock to charity allows you to dispose of the stock without triggering capital gains taxes, while still claiming a charitable deduction. Then you can take the cash you planned to donate and reinvest it in other securities.

Monitoring expired tax breaks. Keep an eye on Congress. If certain expired tax breaks are extended before the end of the year, you may have some last-minute planning opportunities. Expired provisions include tax-free IRA distributions to charity for taxpayers age 70½ and older, the deduction for state and local sales taxes, the above-the-line deduction for qualified tuition and related expenses, and the credit for energy efficient appliances.

Start now

Most strategies for reducing your 2014 tax bill must be implemented by the end of the year, so it's a good idea to start planning now. Uncertainty surrounding the fate of expired tax breaks complicates matters, so contact us today to develop contingency plans for dealing with whatever tax legislation is signed into law.

2014-2015 Tax Planning Guide

Our complimentary 2014 Tax Guide is designed to stimulate conversations. The guide includes tax planning strategies for investors, families and business owners, as well as education, retirement, estate planning and other tax saving opportunities. The on-line guide will be updated automatically to reflect any changes that are made in tax law on the federal level. For more information, click here.

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