MARTINEZ & ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS & BUSINESS ADVISORS

Tax Updates

This update covers some of the provisions being suggested in the President's new budget for fiscal year 2015. I've highlighted the items that are of greatest importance.

2015 Tax Proposals For Businesses

- **Permanently extend increased expensing of qualified property for small business under Code Sec. 179 , with a $500,000 deduction limit and phase-out beginning at $2 million (indexed for inflation for tax years beginning after 2013). Qualifying property would permanently include off-the-shelf computer software, but would not include real property.**

- **Enhance and permanently extend the research tax credit, and increase the rate of the alternative simplified research credit (ASC) from 14% to 17%.**

- Permanently extend the work opportunity tax credit (WOTC) to apply to wages paid to qualified individuals who begin work for the employer after Dec. 31, 2013, and expand the definition of "qualified veteran" for individuals who begin work for the employer after Dec. 31, 2014. Also, for tax years beginning after Dec. 31, 2014, modify the calculation of the credit to equal 20% of the excess of qualified wages and health insurance costs paid or incurred by an employer in the current tax year over the amount of such wages and costs paid or incurred by the employer in the base year. The proposal would also permanently extend the Indian employment tax credit to apply to wages paid to qualified employees in tax years beginning after Dec. 31, 2013.

- Exclude self-constructed assets of small taxpayers (i.e., with annual gross receipts of $10 million or less) from the uniform capitalization (UNICAP) rules.

- **Effective after Dec. 31, 2015, require employers that have been in business for at least two years, have over 10 employees, and do not currently offer a retirement plan to offer an automatic IRA option to employees, under which regular contributions would be made to an IRA on a payroll-deduction basis.**

• Reform the tax treatment of derivative contracts by requiring that all such contracts be "marked to market," with resulting gains and losses taxed each year and treated as ordinary income.

• Repeal the exception from the pro rata interest expense disallowance rule for contracts covering employees, officers, or directors, other than 20% owners of a business that is the owner or beneficiary of the contracts.

• Eliminate special depreciation rules for airplanes not used in commercial or contract carrying of passengers or freight (e.g., corporate jets) by increasing the depreciation period from five to seven years, consistent with the treatment of commercial aircraft.

• Require all corporations and partnerships with $10 million or more in assets, and corporations with more than ten shareholders and partnerships with more than ten partners, to file their tax returns electronically.

• Implement standards clarifying when employee leasing companies can be held liable for their clients' federal employment taxes.

• Permanently extend and modify the New Markets Tax Credit (NMTC), with an allocation amount of $5 billion for each round.

• Provide tax credits to New York State and New York City for expenditures relating to the construction or improvement of transportation infrastructure in or connecting to the New York Liberty Zone. The tax credit would be allowed in each year from 2015 to 2024, inclusive, subject to an annual limit of $200 million.

• Upon enactment, eliminate the deduction for dividends on stock of publicly-traded corporations held in employee stock ownership plans (ESOPs).

• Upon enactment, reform and expand the low-income housing tax credit (LIHTC) by, among other things, providing two ways in which a private activity bond (PAB) volume cap could be converted into LIHTCs, allowing LIHTC-supported projects to elect a criterion employing a restriction on average income, and making the LIHTC beneficial to real estate investment trusts (REITs) and regulated investment companies (RICs).

• **Provide short-term relief relating to the employer Federal Unemployment Tax Act (FUTA) tax by suspending interest payments on the state unemployment insurance (UI) debt, suspending the FUTA credit reduction for employers in borrowing states in 2014 and 2015. Also, the proposal would raise the FUTA wage base in 2017 to $15,000 per worker, index the wage base to wage growth for subsequent years, and reduce the net Federal UI tax from 0.8% (after the proposed permanent reenactment and extension of the FUTA surtax) to 0.37%.**

• **Repeal the last-in, first-out (LIFO) accounting method.**

• **Repeal the lower-of-cost-or market and subnormal goods methods of inventory accounting. Any resulting income inclusion would be recognized over a 4-year period beginning with the change year.**

• Repeal the "boot-within-gain" limitation for dividends received in reorganization exchanges.

• Effective for post-enactment sales and exchanges, expand the definition of "built-in loss" for purposes of partnership loss transfers.

• Effective for a partnership's tax year beginning on or after the enactment date, amend **Code Sec. 704(d)** to allow a partner's distributive share of expenditures not deductible in computing the partnership's taxable income and not properly chargeable to capital account only to the extent of the partner's adjusted basis in its partnership interest at the end of the partnership year in which such expenditure occurred.

- Effective for post-enactment transfers, limit the importation of losses under related party loss limitation rules.

- Effective for damages paid or incurred after Dec. 31, 2015, deny deductions for punitive damages.

- **Modify like-kind exchange rules for real property to limit the amount of capital gain deferred under Code Sec. 1031 from the exchange of real property to $1 million (indexed for inflation) per taxpayer per tax year.**

- Conform the control test under **Code Sec. 368** with the affiliation test under **Code Sec. 1504** such that "control" would be defined as the ownership of at least 80% of the total voting power and at least 80% of the total value of a corporation.

- Prevent the elimination of earnings and profits through distributions of certain stock by providing that a corporation's distribution of stock of another corporation would reduce the distributing corporation's earnings and profits in any taxable year by the greater of the stock's fair market value or the corporation's basis in the stock.

- **Make the 100% exclusion for qualified small business stock (QSBS) permanent. The AMT preference item for gain excluded under Code Sec. 1202 would be repealed for all excluded small business stock gain. Also, the time for a taxpayer to reinvest the proceeds of sales of small business stock under Code Sec. 1045 would be increased to six months for QSBS the taxpayer has held longer than three years.**

- **For tax years ending on or after the enactment date, permanently allow up to $20,000 of new business expenditures to be deducted in the tax year in which a trade or business begins and the remaining amount to be amortized ratably over the 180-month period beginning with the month in which the new business begins. The maximum amount of expensed start-up**

expenditures would be

reduced (but not below zero) by the amount by which start-up expenditures with respect to the active trade or business exceed $120,000. (This would consolidate the existing provisions for start-up expenditures under Code Sec. 195 and organizational expenditures under Code Sec. 248 and Code Sec. 709 .)

- **For tax years beginning after Dec. 31, 2013, expand the group of employers who are eligible for, and simplify, the tax credit available to small employers providing health insurance to employees to include employers with up to 50 full-time equivalent employees, and begin the phase-out at 20 full-time equivalent employees.**

- Tax certain "carried interest" (i.e., interest in future profits of a partnership) income as ordinary income instead of capital gains.

- Increase certainty with respect to worker classification by permitting IRS to require prospective reclassification of workers who are currently misclassified and whose reclassification has been prohibited under current law.

- For distributions made in tax years beginning after the enactment date, repeal the preferential dividend rule for publicly offered REITs.

- Repeal "technical terminations" of partnerships under **Code Sec. 708(b)(1)(B)** .

- Repeal the anti-churning rules for amortization of intangibles under **Code Sec. 197** .

- Require current inclusion in income of accrued market discount and limit the accrual amount for distressed debt.

- **Require that the cost basis of stock that is a covered security must be determined using an average basis method**.

2015 Tax Proposals For Individuals

- **Permanently extend increased expensing of qualified property for small business under** Code Sec. 179 **, with a $500,000 deduction limit and phase-out beginning at $2 million (indexed for inflation for tax years beginning after 2013). Qualifying property would permanently include off-the-shelf computer software, but would not include real property.**

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Miscellaneous Tax Provisions

The budget also includes proposals to:

... Upon enactment, explicitly provide that the Treasury Department and IRS have authority to regulate all paid return preparers.

... **Increase base IRS funding to $12 billion (up from $11.3 billion for 2014). The budget notes that IRS investment pays for itself "several times over" given the revenue return from strong tax enforcement.**

... Establish a "multi-year program integrity cap adjustment" for IRS, including $480 million in 2015, to deliver additional resources to critical tax enforcement and compliance functions that reduce the deficit and narrow the tax gap by nearly $6 for every $1 spent once fully implemented.

... Provide an addition $165 million to IRS to enhance customer service performance.

... Support implementation of the Affordable Care Act (ACA) and build on the ACA by "including $402 billion in additional health savings that will strengthen Medicare and Medicaid and other Federal health programs by implementing payment innovations and other reforms that encourage high quality and efficient care."

... Effective Jan. 1, 2016, impose a "financial crisis responsibility fee" on certain liabilities of the largest firms in the financial sector.

... **Conform Self-Employment Contributions Act (SECA) taxes for professional service businesses, effectively by subjecting individual owners of such businesses organized as S corporations, limited partnerships, general partnerships, and LLCs taxed as partnerships to SECA taxes in the same manner and to the same degree**.

... Increase levy authority for payments to Medicare providers with delinquent tax debt.

... Impose liability on shareholders to collect unpaid income taxes of applicable corporations.

... Increase tobacco taxes and index them for inflation.

... **Reinstate and permanently extend the 0.2% FUTA surtax, effective for wages paid on or after Jan. 1, 2015.**

... Upon enactment, modify tax-exempt bonds for Indian tribal governments.

... Put in place the President's new America Fast Forward (AFF) Bonds program aimed at attracting new sources of capital for infrastructure investment. 2015

... Streamline audit and adjustment procedures for large partnerships, applicable for a partnership's tax year ending on or after the date that is two years from the enactment date.

... Effective upon enactment, increase whistleblower protections by, among other things, amending **Code Sec. 7623** to explicitly protect whistleblowers from retaliatory actions, consistent with the protections currently available to whistleblowers under the False Claims Act.

... Modify certain reporting requirements.

... Effective for returns required to be filed after Dec. 31, 2015, provide for reciprocal reporting of information in connection with the implementation of the Foreign Account Tax Compliance Act (FATCA).

... Upon enactment, index all fixed-amount penalties to inflation and round the indexed amount to the next hundred dollars.

... Strengthen tax administration by, among other things, revising the offer-in-compromise application rules to eliminate the requirement that the initial offer include a nonrefundable payment (effective for offers submitted after the enactment date), making the repeated willful failure to file a tax return a felony, modifying IRS's math error authority and add a new category of "correctable errors," and extending the due diligence requirements that currently apply to paid preparers who prepare returns involving an EITC to also cover returns claiming the child tax credit.

... Extend the statute of limitations where a state adjustment adjusts federal tax liability.

... **Require taxpayers who prepare their returns electronically but file on paper to print their returns with a scannable code, effective for tax returns filed after Dec. 31, 2014.**

... Allow IRS to absorb credit and debit card processing fees for certain tax payments, effective upon enactment.

... Mandate e-filing for exempt organizations for tax years beginning after the enactment date, with transition relief.

... Repeal the telephone excise tax..

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Information for Sound Decision Making