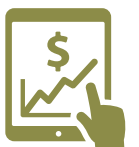


2015 YEAR-END Tax guide.

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2015 YEAR-END Tax guide.

A man returns to his doctor's office to tell her that the medicine she prescribed for his pain isn't working. "Don't you have anything else I can try?" he asks.

"Here. Fill out this tax form."

"How's that going to help me?"

"I can't explain it, but some of my patients insist that it gives them relief."

We're not sure what form the doctor suggested, but many of our clients report that tax forms are as likely to cause a dull ache behind the eyes as they are to relieve any pain. Unless, of course, you're a tax accountant. For us, filling out a tax form can be satisfying, even rewarding.

That said, 2015 has delivered some changes that will affect taxes. The continued phase-in of the Affordable Care Act will see businesses planning for changes that go into effect as of January 1, 2016. The annual political hot potato that is the "extenders" bill could easily have taxpayers guessing about 2015 tax law changes well into early 2016. And the landmark Supreme Court case recognizing constitutional protection for same-sex marriage will result in significant filing and planning opportunities for millions of individuals.

Still, 2015 was relatively stable from a tax code perspective, and any year that offers relative stability provides an excellent opportunity to review current tax positions and strategies. The end of the year is always an important time to make sure that your business or your family is complying with the current rules and maximizing deductions and credits available under the law.

If, after perusing this Tax Guide, you have questions about how the law applies to your specific situation, please give us a call. The professionals at Plante Moran stand ready to help you find relief wherever possible.

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Businesses.

YEAR-END TAX-PLANNING STRATEGIES



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HEALTHCARE REFORM — HOLDING STEADY IN 2016

When we first covered the tax implications of the Affordable Care Act (ACA) back in 2013, the key words were “play or pay.” This reflected an employer’s choice to “play” by providing required levels of health care to its employees or “pay” a penalty into the system to help employees pay to obtain that coverage. The focus was on large employers, defined as those where the sum of full-time and full-time-equivalent (FTE) employees is 50 or more.

Employer Mandate: “Play or Pay” Continues for Employers with 50 or More Employees

On January 1, 2016, the Employer Mandate will be fully phased in. The Employer Mandate pertains to applicable large employers (ALEs) with 50 or more full-time or FTE employees. Employers meeting this threshold must offer coverage to 95% of their full-time employees (and their dependents under age 26) or be subject to penalties (or “shared responsibility payments”). (Prior to January 1, 2016, an ALE could satisfy the requirement by offering coverage to 70%.)

Individual Mandate

The ACA’s Individual Mandate went into effect on January 1, 2014. It requires that all non-exempted individuals meet the ACA requirements by either buying benefits through a variety of sources or being subject to an individual penalty. Penalties are adjusted for each calendar year.

The penalty for failure to have individual Minimum Essential Coverage for 2015 (assessed in 2016) is the higher of (a) \$325 per adult (up to \$975/family) or (b) 2% of household income over the tax return filing requirement threshold for your filing status (penalties for children under 18 without coverage are less than those for adults). For 2016, that penalty increases to \$695 for an adult (up to \$2,085/family) or 2.5% of household income over the tax return filing requirement threshold for your filing status. The penalty is capped and cannot exceed the national average cost of a bronze plan. However, as with any complex law, several exceptions apply.

Employer Reporting

Beginning in January 2016, for the calendar year 2015, ALEs are required to provide Forms 1095-C to each full-time employee and file Form 1094-C with the IRS to demonstrate that the health coverage offered is compliant with ACA requirements. All employers that sponsor self-insured plans also have Form 1094-B and 1095-B requirements regardless of ALE status. Plan sponsors must work closely with their insurance carriers, third-party administrators, payroll administrators, internal human resources and information systems personnel, and benefit plan advisor/broker/agent to retain and monitor the data and prepare the forms. These providers should be contacted immediately to help you comply with these requirements.

SURFACE TRANSPORTATION ACT — TAX PROVISIONS

Although 2015 was another quiet year for tax legislation, in late summer, the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (the “Act”) was passed. The Act is a stopgap measure to provide long-term financing for highway and transportation funding that must be revisited later this year.

As with any act, there are a few major changes and several minor adjustments. The major changes affecting businesses include changes in filing deadlines for certain returns and changes in reporting bases to ensure consistency between estate tax valuations and bases used for income tax purposes for assets acquired from a decedent.

Tax Return Due Dates

The Act accelerated due dates for most partnership tax returns by one month. For calendar-year partnerships, the due date will be moved from April 15 to March 15 beginning with the 2016 calendar-year returns. The Act also generally changed the due date for C corporations one month. For calendar-year C corporations, the due date would be moved from March 15 to April 15. It should be noted that the due date for C corporations with a fiscal year end of June 30 is not affected, presumably to keep the revenue within the government’s fiscal year ending September 30. Lastly, the due date for FBAR (Foreign Bank Account Reporting) forms will be moved from June 30 to April 15, the same date that individual and corporate returns are due. These provisions are effective for tax years beginning after December 31, 2015.

The due date-related provisions will provide greater consistency in reporting with “pass through” entities since S corporation returns and partnership returns will generally be due at the same time and one month before taxpaying

entities (individuals and C corporations). This information will be beneficial to taxpaying entities, which will now generally share a common due date of April 15.

Basis Conformity

When a beneficiary receives an asset from a decedent’s estate, the income tax basis of the asset is the same as the fair market value of the asset reported on the estate’s tax return. Prior to this revision, estates weren’t required to provide detailed information on asset bases to beneficiaries or to the IRS. The new law requires that detailed information be provided to the IRS and to the beneficiary to ensure that the income tax basis used on a subsequent sale of the property is consistent with the valuation used for determining estate tax.

BASIC BUSINESS YEAR-END PLANNING

It’s important that all businesses begin their year-end planning early enough to effectively implement tax-saving strategies. Here are a few tips.

Net Income Deferral (or Acceleration)

Cash basis taxpayers should consider accelerating deductions into 2015 by prepaying eligible expenses. If cash is in short supply, cash basis taxpayers may deduct credit card charges in 2015 that are paid off in 2016. Similarly, cash basis taxpayers should consider deferring income to 2016. Income can be deferred if it wasn’t actually or constructively received in 2015.

Accrual basis taxpayers may generally deduct cash payments made within 2½ months of the tax year end for employee compensation and bonuses. Payments made to long-term incentive plans may also be deductible, though payments to owners may not be. Payments made within 8 ½ months for certain “recurring items” may also be deducted if an election has been made.

The Installment Method of Reporting Gain

Taxpayers selling real estate may consider the installment method, which allows gain to be recognized over the period of time that payments are received rather than reporting the entire gain in the year of the sale.

Other Considerations

Losses from pass-through entities like partnerships, LLCs, and S corporations may not be deductible if a partner, member, or shareholder is passive with regard to the investment or lacks sufficient basis. These basis rules differ by entity type, so determining basis limitations can often be complex.



As we near
year end,
all taxpayers
should have
adopted
policies that
comply with
the new
Tangible
Property
Regulations.

Businesses often have carryovers of tax attributes like research and development credits, foreign tax credits, charitable contributions, capital losses, and net operating losses. It's important to review these attributes and develop strategies to maximize their use. Similarly, businesses should determine if they qualify for any new credits or incentives available under the Internal Revenue Code.

An important tax benefit to domestic manufacturers, farmers, and architecture and engineering firms is the domestic production activities deduction (DPAD). This benefit reduces taxable income by 9% of qualified production activities income. The documentation of qualifying income and activities is important due to increased IRS scrutiny of this benefit.

REPAIR REGULATIONS

In last year's Year-End Tax Guide, we noted that companies were finally preparing to adopt the Tangible Property Regulations passed in September 2013. The regulations provided a long sought after clarification of expenditures that must be capitalized and expenditures that can be deducted as repairs.

As taxpayers grappled with the new rules and reporting for their capitalization policies, the IRS granted relief, in February 2015, to "small taxpayers," defined as those with less than \$10 million in assets or \$10 million or less in average annual gross receipts. The relief eliminated the requirement for small taxpayers to calculate the impact on historical taxable income. However, small taxpayers are required to apply the regulations **prospectively**.

While the Tangible Property Regulations require documentation of policies and procedures and the understanding of new, more complex, capitalization vs. repair rules, they also provide greater clarity. It should also be noted that some changes are taxpayer friendly, so there may be refund opportunities to deduct assets

capitalized under old rules that can be expensed under the new rules.

As we near year end, all taxpayers should have adopted policies that comply with the new Tangible Property Regulations and should be applying the new rules. Since this is the first full year after implementation, now is a great time to make sure that businesses are in compliance with the new rules. Remember, capitalization policies have been updated, and taxpayers should be looking to maximize depreciation and expenses allowed under these regulations.

TAX EXTENDERS

At the time this article was written, a group of 50 credits and deductions known as the tax extenders expired on December 31, 2014. This list includes:

- Research and Development Credit
- Low-income Housing Credit
- New Markets Tax Credit
- Work Opportunity Credit
- Accelerated depreciation of qualified leasehold improvement, restaurant, and retail improvement property
- Accelerated depreciation of certain business property (bonus depreciation)
- Increased expensing allowance for business assets, computer software, and qualified real property (i.e., leasehold improvement, restaurant, and retail improvement property)
- The reduction of the recognition period of built-in gains of S corporations

History has provided ample evidence that most, but perhaps not all, of these important tax deductions and credits will be passed retroactively back to January 1, 2015, and, potentially, extended into 2016. While Congress seems to debate whether to make certain credits permanent (like the Research and Development Tax Credit), budgetary concerns make passage of permanent tax cuts difficult.

ENTITY FORMATION — TAX CLASSIFICATION

When forming a new business, a taxpayer should carefully consider the type of legal entity that should be formed since it may impact liability protection, governance, and registration requirements. The taxpayer should also carefully consider how the entity will be classified for tax purposes.

The most important factor of the tax classification is whether the entity will pay its own tax (like a C corporation) or pass through its income to its members, partners, or shareholders (like S corporations and partnerships).

C corporations are business entities that pay their own tax rather than “passing through” the income to their shareholders. However, C corporation shareholders are subject to a second level of taxation when dividends are distributed by C corporations to their owners. The top income tax rate for C corporations is 35%, while qualified dividends are currently taxed at up to a 20% rate (plus 3.8% surtax where applicable).

S corporations and partnerships generally “pass-through” their taxable income to their owners. The owners, typically individuals, pay the tax on the entity’s income at individual income tax rates. The top individual income tax rate on pass-through income is 39.6% (plus 0.9% or 3.8% surtax where applicable). Although the income tax rate imposed on owners of pass-through entities may be higher than the rate imposed on C corporations, the income earned by pass-through entities is generally not taxed a second time when it’s distributed.

Through most of the last decade, effective individual income tax rates have been higher than C corporation tax rates. As a result, C corporations that don’t pay dividends may have a tax advantage compared to pass-through entities; however, pass-through entities have the advantage of not being subjected to double taxation when dividends are paid. Selecting the

right type of entity and how it’s classified for tax purposes is important to minimize current taxes, taxes on dividends or distributions paid, and taxes on a company’s future sale.

CAPTIVE INSURANCE COMPANIES

Captive insurance companies have been an effective planning tool for U.S. businesses since the 1950s. Captives are used for many different purposes, including easier access to foreign reinsurance markets, the ability to share risks with similar companies with similar risk management goals, or simply to allow greater control over a company’s risks (like health insurance).

While different forms of captives have attracted the attention of the IRS from time to time, the small insurance company (otherwise known as an 831(b) captive) is currently on the IRS’s “2015 Dirty Dozen List of Tax Scams.” This list provides insight into IRS priorities and areas that it will focus on in an audit. The captives being targeted by the IRS are described as those promoted by “unscrupulous promoters” who draft and price insurance policies that cover “esoteric, implausible risks for exorbitant premiums.”

If your company has a captive insurance company, all aspects of the arrangement should be documented and be on an arm’s-length basis.

JOIN US DECEMBER 1, 2015, FOR OUR YEAR-END BUSINESS TAX WEBINAR

Are you prepared to face the good, the bad, and the ugly as you develop and execute an effective year-end tax strategy for your business? Join us December 1 at 2 p.m. EST for a webinar that will summarize the most important information you need to ensure you’re maximizing your business’s tax savings.

Register at webinars.plantemoran.com.



Individuals.

YEAR-END TAX-PLANNING STRATEGIES



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MANAGING TAX RATES EFFECTIVELY

Our tax laws have become extremely complex. Our Internal Revenue Code (IRC) provides for regular taxes, alternative minimum taxes (AMT), and, in the last two years, surtaxes. In addition to these taxes, the law provides for lower maximum tax rates for capital gains and qualified dividends. Lastly, there are provisions for phasing out personal exemptions, itemized deductions, and even the tax-free character of Social Security payments at varying income levels.

All of these variations must be considered when determining which tax applies, what taxable income and allowable deductions apply, and what exemptions or deductions are being phased out. In the examples below we'll discuss how tax rates, surtaxes, and phaseouts impact your tax situation; there's nothing like a good projection to identify and isolate income and deduction items and how they impact your tax bill.

Regular Taxes

The regular tax is the one to which the IRC gives the most attention and the one we normally think of when we think of taxes. It's calculated based on your total income less adjustments, deductions, and exemptions. In 2014, the maximum tax bracket for regular tax was increased to 39.6% before surtaxes.

Alternative Minimum Tax

In 1969, when the tax environment was much different, Congress felt that many high-income taxpayers were escaping the payment of regular

tax through the use of deductions and credits, so they created the AMT. The AMT acts like a flat tax in that it doesn't allow certain deductions and places limitations on credits and exemptions. While it increases the tax base, it decreases the maximum rate. For 2015, the maximum AMT rate is 28%, while the maximum ordinary income tax rate is 39.6%. While the initial law focused on a very small number of taxpayers, the current AMT impacts a far greater number.

In the chart below, you'll note that the AMT does not provide benefits for taxes, miscellaneous deductions, and certain home equity interest expenses. In addition, the AMT can impact large families as exemptions are limited.

DEDUCTIBLE		
EXPENSE	REGULAR TAX	AMT
State & local income tax	Yes	No
Property tax	Yes	No
Mortgage interest	Yes	Limited
Home equity debt interest (not used to improve your purchase residence)	Yes	No
Professional fees	Yes	No
Investment expenses	Yes	No
Unreimbursed employee business expenses	Yes	No

Surtaxes & Phaseouts

In 2013, Congress enacted two surtaxes that impact “high-income” taxpayers. These include a 3.8% surtax on net investment income and a separate 0.9% surtax on wages and self-employment income. Both surtaxes increase a taxpayer’s tax liability on income over designated “modified adjusted gross income” thresholds. In addition to the two surtaxes, “high-income” taxpayers are also subjected to phaseouts that reduce the benefit of itemized deductions and exemption deductions. The phaseout of itemized deductions (also known as the Pease limitation) is the lesser of 3% of the adjusted gross income (AGI) over the applicable threshold or 80% of certain itemized deductions. The Personal Exemption Phaseout (PEP) reduces all personal exemptions (including taxpayers and dependents) by 2% for each \$2,500 that AGI exceeds the applicable threshold. See the table below for applicable thresholds.

FILING STATUS	NET INVESTMENT INCOME SURTAX (3.8%)	EMPLOYMENT INCOME SURTAX (0.9%)	PEASE LIMITATION AND EXEMPTION PHASEOUT
Single	200,000	200,000	258,250
Married filing jointly	250,000	250,000	309,900
Married filing separately	125,000	125,000	154,950
Head of household	200,000	200,000	284,050
Qualifying widow(er)	250,000	200,000	309,900

When you compare the taxation of a taxpayer using regular tax, alternative minimum tax, and adjusting for the surtaxes and phaseouts, it becomes easier to see how these issues can add a significant amount to a taxpayer’s tax bill. In the grid below, the taxpayer starts with an effective tax rate of 23.8% (\$119,199 / \$500,000) that increases to 28.5% (\$142,250 / \$500,000) due to the effects of the alternative minimum tax and the impact of surtaxes.

	REGULAR TAX (without phaseouts)	REGULAR TAX (with phaseouts)	ALTERNATIVE MINIMUM TAX	FINAL TAX: HIGHER OF REGULAR TAX OR AMT PLUS SURTAXES
Wages	200,000.	200,000.	200,000.	200,000.
Business Income	300,000.	300,000.	300,000.	300,000.
Adjusted Gross Income	500,000.	500,000.	500,000.	500,000.
Less: State Taxes	(25,000)	(25,000)	Not Deductible	Not Deductible
Less: Property Taxes	(25,000)	(25,000)	Not Deductible	Not Deductible
Plus: Pease Limitation		5,703.	N/A	N/A
Less: Exemptions (4)	(16,000)	Phased Out	Phased Out	Phased Out
Taxable Income	434,000.	455,703.	500,000.	500,000.
Tax	119,199.	126,795.	140,000.	140,000.
Employment Income Surtax				2,250.
Total Tax	119,199.	126,795.	140,000.	142,250.
Effective Tax Rate	23.8%	25.4%	28.0%	28.5%
Marginal Tax Rate	35.0%	35.0%	28.0%	28.9%



CHARITABLE CONTRIBUTIONS

Giving to charity is wonderful for two reasons: it may benefit a cause that's worthy, and it lowers your tax liability. For tax planning purposes, a charitable contribution can be flexible in many ways. As the donor, you determine the form of donation (cash vs. non-cash), the timing, and the recipient to best meet your needs. But while the gifting is flexible, the required documentation is not.

All donations of \$250 or more must be substantiated with written documentation from the charity stating the amount given and whether the donation was in the form of cash or a non-cash gift. There must also be a statement that "no goods or services were provided in consideration for the contribution." When goods or services are provided, such as in the event of a dinner gala, the fair market value of the goods or services received in return for the contribution must be provided via a contemporaneous donor letter. When non-cash gifts in excess of \$5,000 are contributed, a qualified appraisal is required.

In two recent cases, the IRS denied (and the Tax Court agreed) deductions for cash donations of \$250 or more that weren't supported by a contemporaneous donor letter and non-cash donations in excess of \$5,000 made to a local charity. In both cases, the taxpayers were able to show donative intent and support the actual contribution but did not have the required documentation or appraisal at the time their tax return was filed.

Without adequate documentation, the IRS is quick to challenge these deductions, and the burden of proof falls on the taxpayer.

INVEST IN CHILDREN

If you have children or grandchildren, investing in their futures can provide significant tax benefits. Depending on your combined tax situations, you can invest in them through

tax-advantaged education plans, IRAs or Roth IRAs, or gifts through UGMA (Uniform Gifts to Minors Act) accounts.

Education Vehicles

There are a number of ways to fund your child or grandchild's education. The most popular plans are "529 plans," named after the IRC section that created them. 529 plans provide both gift tax and income tax benefits. They can sometimes provide state income tax benefits, too.

A 529 plan works, in many ways, like a 401(k) plan, except that it's used for educational purposes rather than retirement. Gifts to 529 plans are qualified gifts that are generally excluded from gift taxation, and any income earned by the 529 plan is exempt from income tax if used for qualified purposes. A donor can frontload \$70,000 of contributions (five years of gifts) to these plans. The complexity in 529 plans comes from the fact that there are so many available; each state has its own version. However, it may be beneficial to invest in one in your home state to qualify for state tax benefits that are often available.

Michigan offers a 529 plan: the Michigan Education Savings Plan (MESP). The MESP is a savings plan used as a way to save for tuition, room and board, required books, and other mandatory fees. Michigan also has the Michigan Education Trust (MET), which is a prepaid plan that guarantees tuition and mandatory fees at Michigan public colleges. Both offer a deduction for state purposes of up to \$10,000 (\$5,000 for individuals filing single).

Ohio offers two 529 plans: the direct-sold Ohio CollegeAdvantage 529 savings plan and the BlackRock CollegeAdvantage plan. Illinois has three 529 college savings plans available. You can choose from the Bright Start College Savings Program or the Bright Directions College Savings Program. You also could invest in the College Illinois! 529 Prepaid Tuition plan.

IRAs and Roth IRAs

If your child or grandchild has a job, you may consider giving them a gift that can be used to set up an IRA, or, better yet, a Roth IRA. Since your child will generally be in a low tax bracket, there will be little benefit from the tax deduction that a traditional IRA provides. By contributing to a Roth IRA, your child or grandchild will start building a fund that will be tax free when they retire many years in the future. The earnings will continue to compound tax free until withdrawn.

UGMA/UTMA Accounts

Lastly, an easy way to provide a straight gift to your child or grandchild is through a UGMA or UTMA (Uniform Transfer to Minors Act) account. These are opened at your local bank or financial institution. The account name is required to read, “[Adult], trustee for [Child] Under UGMA or UTMA.” The account would be opened in the social security number of the child and would be taxable to him/her. The child cannot request a withdrawal from a UGMA account until his 18th birthday or from a UTMA account until his 21st birthday. The adult can request withdrawals but only for non-basic needs of the child (no room and/or board).

SAME-SEX MARRIAGE

In 2013, the U.S. Supreme Court ruled that same-sex marriages would be recognized for federal tax purposes, allowing same-sex married couples to file as married-filing-jointly on their federal 1040s. On June 26, 2015, the Court ruled that the Constitution guarantees the right for same-sex couples to marry in all 50 states. This means that all same-sex married couples are now required to file as married-filing-jointly or married-filing-separately on their state tax returns as well.

This applies to any same-sex couples who are filing their 2014 returns after the ruling date and can greatly simplify the filing process.

Prior to the ruling, same-sex couples living in a state that had a ban on same-sex marriage could have filed up to five returns — a joint federal return, two separate state returns, and two mock federal married-filing-separate returns. It’s important to note that the ruling only applies to legally married same-sex couples, not registered domestic partnerships, civil unions, or similar relationships.

IDENTITY THEFT

Tax-related identity theft occurs when someone uses another taxpayer’s Social Security number to file an unauthorized return with the intent of claiming a refund. Most unsuspecting victims find out that their identities have been stolen when they attempt to file their legitimate returns and the IRS notifies them that another return was already filed using their Social Security numbers. The IRS is devoting significant resources to combat tax-related identity theft through a strategy that includes prevention, detection, and victim assistance. A number of states are also announcing new steps and safeguards to fight identify theft. Please see the article on page 16 devoted to preventing identity theft.

Tax-related identity theft is on the rise. If you’re a victim, the IRS has outlined actions you should take quickly to begin fixing the problem. These include:

- File a report with local police and the Federal Trade Commission at www.identitytheft.com.
- Contact one of the three major credit bureaus (Experian, Equifax, and Transunion) to place a fraud alert on your credit record, and close any accounts opened fraudulently.
- Call the contact number on any IRS Notice received by the taxpayer, and complete IRS Form 14039 (Identity Theft Affidavit) to flag the account for further questionable activity.
- Continue to file returns and pay taxes due in paper form until your account is corrected.

If you’re a
victim of
tax-related
identity theft,
the IRS
has outlined
actions you
should take.



- Contact the Identity Protection Specialized Unit at 1.800.908.4490 to follow up on IRS activity on your account or to report further unauthorized access to your tax returns.

Other helpful information from the IRS can be found on the Taxpayer Guide to Identity Theft page at www.irs.gov/uac/Taxpayer-Guide-to-Identity-Theft.

NEW FBAR PENALTY LIMITS

U.S. citizens are required to report the income from foreign bank accounts, mutual funds, and other investments. U.S. citizens and residents must also report the names and addresses of foreign institutions, bank account number information, and year-end or maximum balances in the account(s) when they're above certain thresholds. These balances are reported on FinCEN Report 114 (Report of Foreign Bank and Financial Accounts) and Form 8938 (Statement of Specified Foreign Assets).

While it may seem unbelievable, the law, as it's currently written, would allow for penalties of up to \$600,000 on a \$20,000 bank account. The annual penalty for willful non-filing of the FBAR report is 50% of the balance or \$100,000, whichever is greater. The penalty is capped at a maximum of six years.

In order to encourage taxpayers to come forward voluntarily, the IRS has introduced a series of voluntary disclosure programs, streamlined filing processes, and relaxed penalty guidelines. For eligible taxpayers, reduced penalties ranging from 0% to 50%, applied only to a single year, may be available. Filing periods range from 3 to 8 years.

ESTIMATED PAYMENTS AND WITHHOLDING

Taxpayers with significant non-wage income (and even those with wages with a significant bonus element) must generally make quarterly estimated payments to ratably pay their tax bills

throughout the year to avoid penalties connected with underpayments. States also have similar estimated tax rules, and many have high penalties for noncompliance.

There are several methods available for taxpayers to calculate their estimated taxes. Two of the methods — prior-year exception and annualized income — are safe harbors. The crystal ball calculation, however, becomes a bit hazier.

Prior-Year Exception

As the name implies, the prior-year exception method relies on the prior-year income and taxes paid. In general, the prior-year exception rule provides that you won't receive a penalty in the current year if your withholding and estimated taxes paid are at least equal to 100% of last year's total tax. If your prior year's AGI was more than \$150,000 (\$75,000 if you're married filing separately), the percentage increases to 110%.

Annualized Income

For taxpayers with more complex tax situations, the annualized income installment method should be used. This method requires taxpayers to do a "mini-tax return" quarterly and annualize taxable income for each quarter to arrive at taxable income for a full year. The calculated tax on the full year is allocated over each quarter (with 25% due at April 15, 50% cumulative due on June 15, 75% cumulative on September 15, and 100% due on January 15). While this method is more complex, it's often more beneficial when income is lower compared to the prior year or when income will be earned later in the year.

Crystal Ball Calculation

When one of the two previous safe harbors may not apply, you may rely upon your final actual income to calculate your tax liability.

This method is beneficial if you're aware that income late in the year will be lower than early in the year. As long as you pay in at least 90% of the total current year tax liability spread evenly over four quarters, penalties do not apply.

Mix and Match

This allows a taxpayer to mix prior-year exception, annualized income, and crystal ball methods in different quarters depending on which method provides the lowest safe harbor amount. This can be beneficial if extraordinary income occurs early in the year or if you can accurately predict your ultimate annual income.

There are several methods for calculating estimated taxes. Prior-year exception and annualized income are safe harbors, but the crystal ball calculation becomes a bit hazier.

JOIN US DECEMBER 1, 2015, FOR OUR YEAR-END INDIVIDUAL TAX WEBINAR

Join Plante Moran's personal tax experts as they provide updates on 2015's top year-end tax planning tips for individuals. Are you prepared to face the good, the bad, and the ugly as you develop and execute an effective year-end tax strategy? Register for the 10 a.m. session at webinars.plantemoran.com.



Estate planning.

NO TIME LIKE THE PRESENT FOR GIFTS



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It's been said that we make a living from what we get, but that we make a life from what we give. All too often, estate planning gets so focused on protecting what we've accumulated that we forget the simple joy of sharing what we have with those we love. The great news is that the best estate plans can also include plans for gifts while you're still alive. If your plan only covers what happens when you die, you may be missing out on a lifetime of wealth transfer opportunities and the joy and inspiration they can bring to the recipients.

In 2015, the annual exclusion amount for gift tax purposes is \$14,000. The exclusion applies to gifts from one individual to another, so a couple could give up to \$28,000 to each child or grandchild every year without tax consequence. But before you do that, let's look further into the reasons we give to future generations.

CREATING OPPORTUNITIES

Few things create opportunities for future generations like education. If you have a child or grandchild in college or private school, any payments you make for tuition are exempt from gift tax. What's more, these payments don't count toward calculating the \$14,000 annual exclusion. In order to qualify, the payments must be for tuition (room, board, or books don't count), and you have to pay the money directly to the educational institution.

EASING FINANCIAL BURDENS

If you know your loved ones will face a specific financial challenge this year or next, plan now to use whatever portion of your \$14,000 exclusion is necessary to help them through. If unforeseen medical expenses arise, you can help by paying bills directly to the healthcare provider on their behalf and, just like tuition, those payments won't count against your annual exclusion.

BUILDING GOOD FINANCIAL HABITS

When it comes to good financial habits, debt management is a critical skill to master. You can use your wealth to help foster this habit in your children and grandchildren by making intra-family loans to them for things like purchasing their first homes or starting their own businesses. If the loan doesn't exceed \$10,000, the person loaning the money doesn't have to recognize interest income on his or her tax return. However, interest in line with applicable federal rates should be charged on these loans to ensure compliance with gifting rules. By loaning interest-free (\$10,000 and below) or at rates below what a bank would charge (amounts above \$10,000), you build financial responsibility in your heirs and save them money compared to interest rates they'd pay through conventional financing.

LEAVING A FINANCIAL LEGACY

It's important to feel like you've made a difference, whether in the lives of those closest to you or by benefitting a charity that's of particular importance to your family. One way to instill the pleasure of giving into children and grandchildren is to select an organization together and then observe the ways in which it's able to assist those in need.

If you plan ahead to make full use of your gift exclusion every year, you can make sure that you have sufficient tax-free gifts available for some of the more fun reasons to share, such as celebrating special events or taking family trips that build memories everyone will treasure. It's still important to plan your estate to minimize the impact of taxes on it, but it turns out that sharing wealth with your heirs while you're still here to enjoy it with them is a key part of making that happen.

For more information on transferring wealth to children, check out our recent webinar, "A Legacy of Stardust: Transferring Wealth to Your Grandchildren," at webinars.plantemoran.com.

The best
estate plans
include gifting
to family
while you're
still alive.



Wealth management.

IT'S ALMOST 2016. DO YOU KNOW WHAT YOUR TAX RATE IS?

Hint: It's not as simple as looking at the income tax brackets.



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If we asked 100 Americans to tell us what federal income tax rate they paid last year, we could easily get 100 different answers. Perhaps the best answer is, instead, a question: "Which one?"

As discussed in our individual tax section (see page 6), taxpayers are subject to regular tax, alternative minimum tax, capital gains tax, surtaxes, and phaseouts. Knowing your true tax rate is difficult due to the number of different rates that may apply and is more complicated than knowing your "tax bracket."

Your total tax as a percentage of all income is your effective tax rate. The incremental tax as a percentage of the next dollar of income is your marginal tax rate. While both the effective and marginal rates are important, the marginal tax rate is the basis for tax planning. Understanding your balance sheet — and the types of investments on it — is an important tool in determining not only your marginal tax rate but also your overall tax efficiency.

To help understand how asset types affect your marginal tax rate, consider these asset types and the factors that affect the taxation of the income they generate:

- **The Human Asset — Compensation:** Salaries, bonuses, options, and other forms of compensation are generally taxable while fringe benefits like health insurance and payments to retirement plans generally aren't. You may want to consider timing income so that it's paid in years when a lower marginal rate applies.
- **Investment Assets:** Your portfolio investments often have different income tax treatments depending on their types. Bonds may pay

interest that's taxable or tax-free. Stocks may pay dividends that are taxed at ordinary rates or "qualified" dividends that are taxed at preferential rates. Capital gains are generally taxed at preferential rates lower than ordinary income, but there are several exceptions. Proper planning requires that you weigh risk against reward (net of appropriately estimated taxes).

- **Business Assets:** If you're involved in a business, directly or indirectly, it's critical to understand how the business is structured for tax purposes since different tax regimes apply, depending on the business's tax classification. It's also important to understand "active" vs. "passive" activities for tax purposes (see page 3). This classification can have a significant impact on how income and losses are grouped and whether losses can be deducted.

WHAT YOU OWE SHOULD NEVER BE A SURPRISE

Good income tax planning means you should never be surprised by how much you owe or when you owe it. A tax advisor's understanding of your balance sheet helps them understand the assets you own and the tax implications of the assets' income and related tax deductions.

As we near the end of the year, it's important to review your current wealth management strategies to ensure you're getting maximum returns on investments and that tax strategies are properly implemented. Understanding your balance sheet is the cornerstone of effective wealth management and tax planning.

If you'd like a preliminary, complimentary review of your balance sheet, email bulletproof@plantemoran.com.

Tax controversy.

DOWNSIZING AT THE IRS

Recent Congressional budget cuts lead to fewer IRS agents.

Earlier this year, the IRS trimmed its staff by 1,800 tax collectors, resulting in 46,000 fewer office audits conducted annually. Great news, right? Except that the IRS does much more than audit taxpayers. As a result of the cuts, its ability to process returns, answer questions, and solve issues like identity theft is impacted.

IRS Commissioner John Koskinen recently wrote to IRS employees that “this year we are looking at a situation where realistically we have no choice but to do less with less,” acknowledging that, even with greater efficiency, IRS services cannot remain constant with staffing down 10% since 2010.

Taxpayers will see the impact of “less with less” in several ways:

- **Technology improvement delays** — Budget cuts have prevented the IRS from updating computer systems and acquiring new equipment at a time when data breaches are on the rise and greater efficiency from workers is expected.
- **Slower phone services** — Along with IRS staff reductions, an across-the-board hiring freeze has prevented filling job vacancies. For taxpayers contacting the IRS for technical issues, hold times, which were never good, can extend to an hour or more. These delays also extend to popular services like obtaining employer identification numbers and more alarming ones like issues connected with increased identity theft. (See related article on page 16).

- **Increased correspondence audits** — While office audits have decreased, the number of correspondence audits continues to grow. These audits are completed almost exclusively through the mail. In many instances, no specific agent or IRS representative is assigned to the audit, making it difficult to work through a complicated issue. Given the delay in communication, these audits can extend for quite a long time.
- **Increased matching notices** — A matching notice is sent when a company sends a Form W-2 or 1099 to the IRS that’s been omitted from a Form 1040. The IRS’s automated matching system will trigger a notice identifying the discrepancy and the tax obligation. With less oversight, incorrect matching notices are being sent, resulting in more taxpayer and advisor time to resolve the issues.
- **Show me the money** — While the IRS performs many functions, its ultimate mission is to collect all taxes owed to the government as efficiently as possible. Ultimately, a smaller IRS impacts the ability of the agency to serve taxpayers through efficient customer service and to identify — and collect from — taxpayers that aren’t paying their fair share. A smaller IRS means that taxpayers will often spend more time to get necessary services and that less revenue will be collected for the government to fulfill its obligations.

A shrinking IRS means longer hold times, slower services, and increased vulnerability to data breaches and identity theft. While we wait for a return to the days of “more with less,” let’s try to enjoy the fewer IRS visits while tolerating the slower service.



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Fraud.

GONE PHISHING

Identity thieves are filing false returns and obtaining tax refunds — all in the name of unsuspecting taxpayers.



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There's an epidemic hitting taxpayers, and it's unrelated to more cumbersome tax laws. Identity thieves have been filing fraudulent returns and receiving refunds — all in the name of other taxpayers.

It's been discomfoting to learn about the rising number of taxpayers who've submitted tax returns only to learn from the IRS that they had, unknowingly, already filed and received a refund. Here's how the scheme works.

Using someone else's name and Social Security number, identity thieves file a false tax return, creating fictitious W-2s showing employment and detailing that a refund is due. The online filing process is simple, allowing most thieves to file numerous fraudulent returns in a day.

The refund checks are mailed to the address or to the bank account listed on the return — and of course, neither reflects the actual taxpayer's information. While this discrepancy prevents a large number of refund requests from being processed, others get through at a cost of billions of dollars annually to the IRS and taxpayers.

This causes undue stress and hardship for the victims. If you're a tax fraud victim, the IRS freezes your refund, pending an investigation. And as mentioned on page 15, agency reductions have caused a backlog of claims that can take months to resolve — a process that leaves victims unable to obtain their refunds.

It's all possible because the thieves are able to gain access to personal information, which in many cases is offered voluntarily — albeit unwittingly. To reduce the risk of identity theft in tax-related schemes, keep the following in mind:

- **The IRS does not email taxpayers.** Don't fall victim to phishing emails that seek to extract your personal information. The temptation can be great, as identity thieves can disguise websites and emails to appear legitimate. For example, some company employees have received emails with instructions to wire funds that appear to come from company executives or board members. If you're uncertain about the authenticity of IRS-branded correspondence, contact your local IRS office to verify.
- **The IRS does not call taxpayers to request personal information.** The IRS already has your information, so there's no need to call you. As a general rule, never give out your Social Security number over the phone to someone requesting it.
- **The IRS opts for snail mail.** The IRS uses regular mail almost exclusively to correspond with taxpayers. Identity thieves understand this and also use paper correspondence to solicit personal information. If you're in doubt about the legitimacy of an IRS letter, contact your local office to verify.

The IRS is aware of the identity theft epidemic and has instituted measures that are becoming increasingly effective at preventing fraud.

However, it's a cat-and-mouse game, and identity thieves are staying ahead of the chase. In the meantime, awareness and skepticism are your best tools to prevent becoming a victim.

Tax solutions.

NARROWED “INTERNAL USE SOFTWARE” DEFINITION IS GOOD NEWS FOR MANY

Historically, it’s been difficult for internal use software (IUS) to meet the stringent criteria to qualify for a research and development (R&D) tax credit. That hasn’t changed.

Back in January, however, the IRS released guidance that narrowed the definition of what’s considered to be IUS. This will likely have a positive impact on taxpayers looking to claim the R&D credit related to their software development activities.

A QUICK REFRESHER ON THE R&D CREDIT

To qualify for the R&D credit, an activity must meet four criteria:

- It must relate to a new or improved product or process intended to improve function, performance, reliability, or quality.
- It must be intended to discover information that eliminates uncertainty related to the capability, method, or appropriate design of a product or process.
- It must fundamentally rely on engineering, physical, biological, or computer science.
- The activities must undergo a process of experimentation such as testing, evaluation of alternatives, simulations, and developing prototypes.

Software considered to be IUS must meet all of these criteria plus all of these higher threshold requirements to qualify for the credit:

- Reduction in cost or a measurable improvement that’s substantial and economically significant.
- Commit substantial resources to the development and have substantial technical risk.

- Cannot be purchased, leased, or licensed and used for the intended purpose without modifications.

That’s a tall order. No wonder IUS rarely qualifies.

BUT IUS NO LONGER INCLUDES...

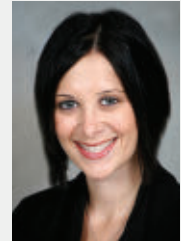
The new rules expand the definition of software to say that software “sold, leased, licensed, or otherwise marketed to third parties” is not considered IUS. They go on to exclude software that enables the business “to interact with third parties.” Examples may include software developed to execute mortgage loans, purchasing tickets for entertainment, and customer tracking the delivery of goods. This narrower definition allows items formerly considered IUS to qualify more easily for the R&D credit.

SO WHAT IS IUS?

The new rules provide some clarification around what types of software should be classified as IUS by stating that the designation should apply to software developed “for use in general and administrative functions,” such as financial management, human resources, and support services that target the back-office functions necessary for nearly every organization to operate.

IN CONCLUSION

These new rules will have a positive outlook for many businesses. To learn more about the IUS regulations, check out our recent webinar, “Sharpen Your Focus on Internal Use Software R&D Regulations,” at webinars.plantemoran.com.



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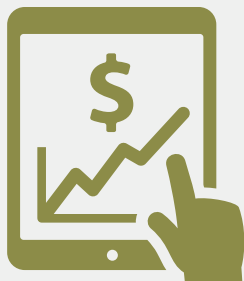


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Not-for-Profit.

ALTERNATIVE INVESTMENTS: BEWARE OF UNEXPECTED UNRELATED BUSINESS INCOME



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Not-for-profit organizations (NFPs), like most investors, have always sought the right balance between returns on funds invested and the risk that must be assumed to achieve higher returns. In recent years, NFPs have seen a significant increase in the types of investments available to them. One key to evaluating an alternative investment opportunity is understanding what new types of income it might generate and what taxes or filing obligations, if any, come with it.

Alternative investments include opportunities like commodities, hedge funds, private equity, and private real estate. However, these investment vehicles can also create headaches for NFPs, including increased tax complexity due to the structure of the investment, potential increases in unrelated business taxable income (UBTI) and state income taxes, and foreign investment reporting obligations.

Many alternative investment strategies involve interests in limited partnerships. Income generated through limited partnerships flows through to the partners in the same form it was received by the entity. The income received from the partnership is reported to the NFP and the IRS on Schedule K-1.

Depending on what type of income an alternative investment generates, the NFP may have to file additional information returns and could owe taxes on UBTI. If the NFP owes federal taxes on UBTI, there's a good chance that it will also be liable for similar taxes at the state level.

Alternative investments that include foreign components may also generate additional reporting obligations on the NFP. Even though there may not be any tax owed on that income, there will still be a cost associated with preparing and submitting the information returns. If the NFP fails to file a required information return for a foreign investment, the penalties can be severe.

None of the issues described above should prevent an NFP from participating in an alternative investment opportunity if the risk and return are in line with the organization's overall investment strategy. If your organization is considering investing in a limited partnership, hedge fund, or other alternative vehicle, make sure that the costs of any additional taxes and tax compliance are considered when calculating the return on investment. Moreover, be sure you understand the tax filing obligations that result from ownership of the investment. Unrelated business income isn't necessarily a bad thing, but unexpected unrelated business income can cause significant problems.

State and local tax.

AFFILIATE NEXUS: WHERE YOU PAY MAY DEPEND ON WHERE YOUR CUSTOMERS CLICK

In the pursuit of more revenue, states are pushing the envelope to redefine who they target as taxpayers. “Click-through nexus” is a new strategy that states are using to collect sales tax from Internet-based retailers selling into their states.

Generally, states aren’t allowed to impose sales tax on retailers with no physical presence in their states (stores or warehouses, for example). However, they are allowed to impose sales tax if an Internet retailer sells into a state in which they also have a brick-and-mortar presence. Think of buying mail-order clothing from JCPenney or Sears that have brick-and-mortar stores in every state as compared to pure Internet retailers that don’t charge sales tax. “Click-through nexus” is a blurring of these principles.

Click-through nexus applies when an Internet retailer with no physical presence in a state compensates an in-state business that does have a brick-and-mortar presence for sales originating from a website link hosted by the in-state business. It doesn’t matter if that in-state business is related or unrelated.

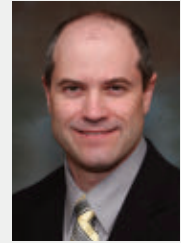
When a resident of that state clicks on the in-state business’s website link, most current laws would treat the sale as simply being shipped into that state by the out-of-state

Internet retailer. As of the writing of this article, 18 states (including Illinois, Michigan, and Ohio) have enacted some form of legislation for click-through sales that are greater than a threshold amount (typically \$10,000 or more annually).

These new laws presume that the out-of-state Internet retailer has nexus in the state unless written clauses exist in an agreement between the parties. These clauses must specifically prohibit the in-state business from engaging in any form of solicitation or other advocacy within the state on behalf of the Internet retailer. The new laws shift the traditional burden of proof from the state to required clauses in a written agreement.

As one would expect, these new click-through laws have been challenged in state courts with differing results. To resolve the differences in state court opinions, the U.S. Supreme Court may have to consider this issue. Alternatively, Congress is considering legislation that would include a nationwide threshold of \$1 million in Internet sales annually.

Differing standards for nexus between states is not new, and it won’t disappear without some form of federal legislation or Supreme Court ruling. However, that doesn’t seem likely in the foreseeable future, so caveat venditor. (Let the seller beware.)



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International.

OPERATING INTERNATIONALLY? 4 HOT-BUTTON ITEMS TO CONSIDER



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Every year, it seems like more families and businesses face international tax issues. Some recognize this ahead of time and plan properly, while others find out after the fact and suffer the consequences. Here are four international tax issues that we think more individuals and businesses need to understand and address.

ESTATE PLANNING CONSIDERATIONS

As more individuals and families grow across national boundaries, we've seen an increase in the need for cross-border estate and inheritance tax planning. Failure to plan before the occurrence of an event (like a relocation) can lead to increased costs and reduced planning options. Persons with interests in foreign estates and trusts also face complex compliance requirements. Failure to meet those requirements in a timely manner can result in severe penalties.

STRENGTHENING U.S. DOLLAR

The U.S. dollar strengthened significantly in the last year. A stronger dollar can cause issues that individuals and businesses need to consider when planning for taxes. Fluctuations in exchange rates may create taxable gains or losses on transactions conducted in foreign currencies. Those fluctuations impact how you calculate your current taxable income if you're doing business in a different currency.

FOREIGN TAX CREDITS

Anytime a U.S. business, its subsidiary, or an individual is subject to foreign tax, they may also be subject to tax in the United States on the same income that was subjected to foreign tax. To mitigate this double taxation, U.S. taxpayers receive a credit for taxes paid to foreign jurisdictions. The calculation of this foreign tax credit can be very complex. Factors such as the sourcing of transactions (especially transactions between related parties or disregarded entities), the required allocation of expenses between foreign and domestic sources, and carry-forwards of overall foreign losses and overall domestic losses can add multiple layers of complexity to foreign tax credit calculations.

HOLDING COMPANIES

When U.S. businesses use controlled foreign corporation (CFC) subsidiaries to operate in other countries, earnings from those CFCs are generally subject to U.S. tax when profits are repatriated to the United States. In some cases where multinational businesses use offshore earnings for purposes such as funding non-U.S. acquisitions or supporting "cash poor" CFCs, inefficient structures may not allow for this to happen without triggering repatriation of those earnings to the U.S. When faced with this problem, an offshore holding company may

provide a solution. With an offshore global holding company structure, CFCs can be owned by a holding company located in a tax-favorable jurisdiction. Earnings can then be moved between various CFCs through the holding company without triggering repatriation treatment in the United States.

AWARENESS AND PLANNING ARE CRITICAL

Taxes are usually the last thing on your mind when you find your life crossing borders, but they're a critical consideration. This is an excellent time to take stock of the previous year and look at the one ahead to determine if your planning should include a discussion with an international tax professional.

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