December 23, 2014

Dear Client:

The purpose of this letter is to remind you of certain recent and proposed tax law changes which will affect many of our clients. The most significant changes will only affect **high-income taxpayers** and **certain businesses**.

A. Good news. A lot of tax breaks expired after 2013, but as many expected, **Congress has retroactively extended** them for 2014. These provisions expire after 2014. These tax breaks include:
   1. **50% bonus depreciation** on new personal property and certain leasehold improvements.
   2. **Section 179 deduction** of $500,000.
   3. **15-year recovery period for leasehold improvements** for restaurant and qualified retail improvement property and these properties continue to qualify for the 50% bonus depreciation and $250,000 Sec. 179 deduction.
   4. $250 above-the-line deduction for **expenses of school teachers**.
   5. Deduction for **state sales tax** in lieu of state income tax.
   6. **Tuition deduction and tuition credits** still in effect.
   7. Tax free direct rollover from an **IRA to a charity**.
   8. Deduction for **mortgage insurance premiums**.
   9. Almost all of the **energy efficient credits**.
   10. The **S Corp built-in gains tax waiting period** remains at 5 years.

B. Remember that tax rates for **high-income** taxpayers went up in 2013, and some new taxes and phase-outs went into effect.
   1. A new **39.6% top bracket** was added for joint income over $457,600 and single income over $406,750.
   2. The troublesome **phase-outs of itemized deductions and personal exemptions** went back into effect in 2013 for income over $305,050 joint or $254,200 single. These phase-outs, in effect, add about 2% to the top tax rate.
   3. The **long-term capital gains rate** increased from 15% to 20% for income over $457,600 joint or $406,750 single.
   4. Congress added a new **3.8% Net Investment Income Tax** on net investment income when AGI exceeds $250,000 joint or $200,000 single. Net investment income includes:
      a. Interest, dividends, royalties, and rents;
      b. Passive income;
      c. Gains from sales of property
   5. There is a new **.9% Additional Medicare Tax** on wages and self-employment income over $250,000 joint and $200,000 single. Employers are required to withhold the extra .9% when employee income exceeds the thresholds but no additional employer matching is required.
   6. Note that although the top bracket is 39.6%, the effect of the new phase-outs and the new taxes could push the effective tax rate over 45%.

C. The meat of the Affordable Care Act went into effect in 2014. The main purpose of the Act was to give everyone not already covered by Medicare or Medicaid an incentive to acquire health insurance. This was done in three main ways:
   1. The **Individual Mandate:** Individuals without health insurance will have to pay an excise tax of about 1% of household income in excess of 1040 filing thresholds.
   2. The **Employer Mandate**: Employers who employ 50 or more full-time employees must provide health insurance for their employees or pay a penalty tax of $2,000 per employee. This penalty will not be imposed until 2015.
   3. Health insurance premiums for low-income individuals will be subsidized through a **Refundable Premium Assistance Credit,** which is designed to limit net premiums to 9.5% of household income**.** Household income is estimated when health insurance is acquired through a federal or state exchange. Actual household income is determined when the tax return is filed. If household income is less than estimated, taxpayers will receive an additional refundable credit. If household income is more than estimated, the taxpayer owes the IRS the excess credit received**.**

D. New capitalization regulations went into effect in 2014**.** This is an entirely new set of rules to determine what may be expensed vs. what should be capitalized or inventoried. These rules may require taxpayers to file Form 3115, Change of Accounting Method. Here are some highlights:
   1. The regulations provide for a **safe-harbor election** whereby individual items that do not exceed $500 may be expensed.
   2. There are now specific and complex rules defining what constitutes **improvements**, which must be capitalized, vs. **repairs and maintenance** costs which may be expensed.
   3. There are now specific rules to determine which **materials and supplies** must be inventoried vs. those that may be expensed when purchased.

E. The **$5,340,000 estate tax exclusion** amount has been made permanent (unless Congress decides to change it) and is indexed for inflation. Furthermore, the exclusion is portable, meaning surviving spouses may add the unused portion of the deceased spouse's exclusion to their own. The IRS will allow individuals who died in 2011, 2012 or 2013 to file an estate tax return by 12-31-2014, even though they were not required to, in order for the decedent's unused exclusion amount to be available for the surviving spouse.

As you can see, most of the recent and proposed changes only affect **high-income taxpayers**, **businesses with significant investments in capital assets**, and **large employers**. We expect some of our **farmer** clients to be affected by the new rules for deducting supplies.

Please call us with any questions and let us know if you want us to look into your specific situation.

We wish you a wonderful holiday season!

Sincerely,

EATON, BABB & SMITH, P.A.