Top Producer Seminar

Are You Ready for A Wild Tax Ride?

Paul Neiffer, CPA
CliftonLarsonAllen, LLP
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Are You ready for a Wild Tax Ride?

Topics

- The Deceptively High 2013 Tax Rates
- Off the Depreciation Cliff?
- ObamaCare – How Does it Affect You?
- Tax Reform – Is This the End of the Cash Method of Accounting for Top Producers?

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2013 Tax Rates

- American Taxpayer Relief Act (ATRA) of 1-2-13 made former 6 tax brackets permanent
  - 10% - 15% - 25% - 28% - 33% - 35%
- Added 39.6% bracket on taxable income above:
  - $400,000 single
  - $450,000 joint

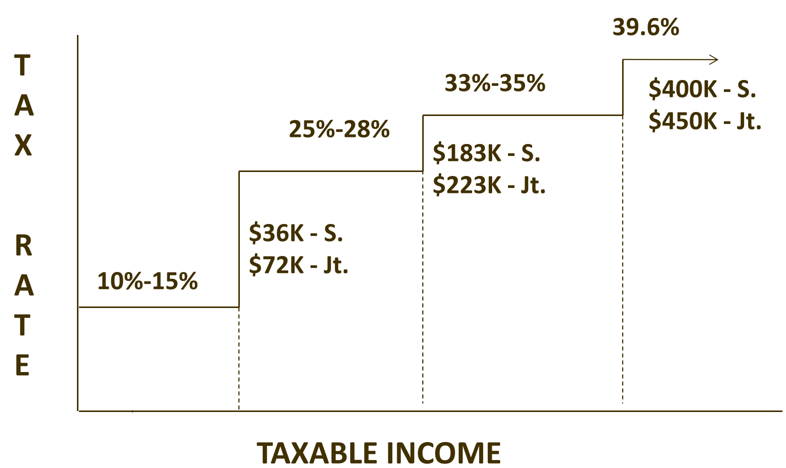
2013 Single Income Tax Rates

Taxable Income	%
$ 0 – $ 9K	10%
9K – 36K	15%
36K – 88K	25%
88K – 183K	28%
183K – 398K	33%
398K – 400K	35%
> $400K	39.6%

2013 Joint Income Tax Rates

Taxable Income	%
$ 0 – $ 18K	10%
18K – 72K	15%
72K – 146K	25%
146K – 223K	28%
223K – 398K	33%
398K – 450K	35%
> $450K	39.6%

2013 Tax Rate Tiers: The Critical Thresholds



2012-2013 Capital Gain & Dividend Rates

Ordinary Rates	2012 Cap. Gain %	2013 Cap. Gain %
10% - 15%	0%	0%
25% - 35%	15%	15%
39.6%	- -	20%

- New 20% rate applies at $400,000 single or $450,000 joint taxable income

Brackets: Dividend & Capital Gain Rates

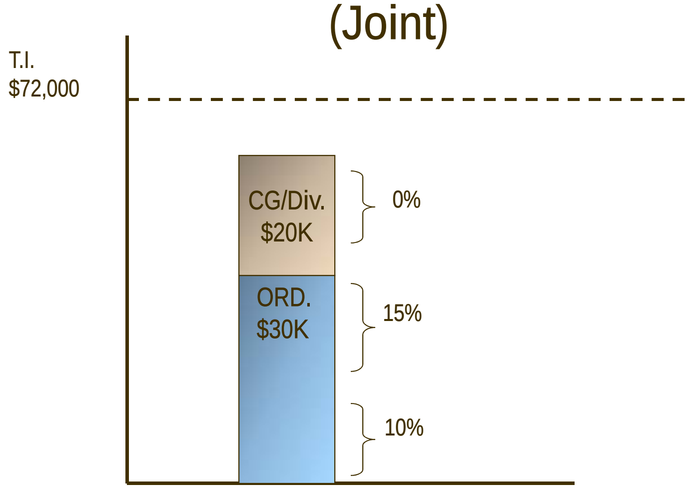
	Taxable Income	
	Single	Joint
0% cap. gain/div. rate	< $36K	< $72K
15% rate	$36K – 400K	$72K – 450K
20% rate	> $400K	> $450K

Capital Gain Rates

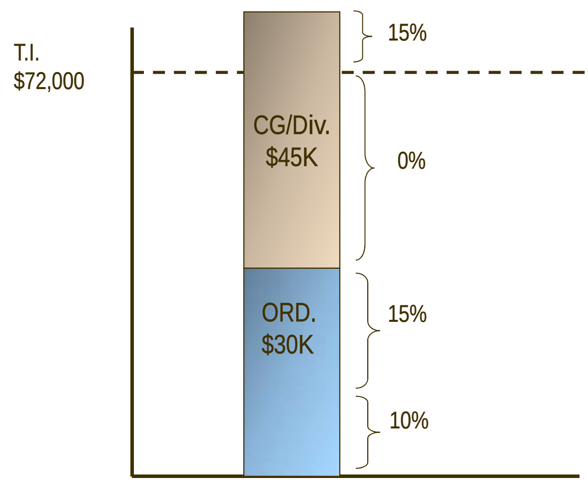
- Apply to assets held over 12 months
- Capital gain rate determined by taxpayer's regular bracket
  - Ordinary income first
  - Capital gains and dividends second

Capital Gains & Dividends: 0% Rate

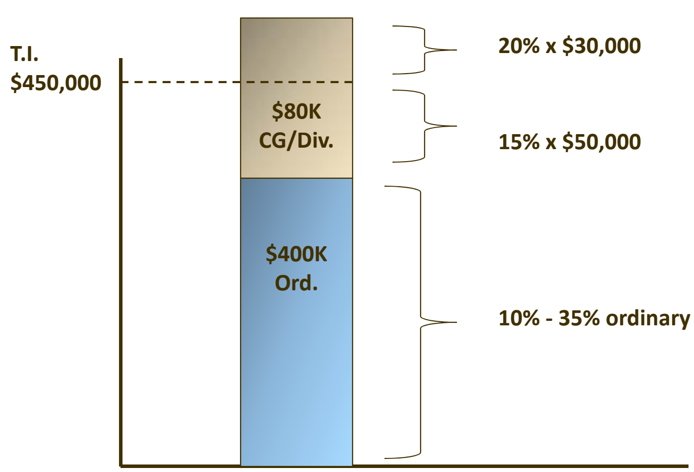
(Joint)



Capital Gains & Dividends: 0% Rate



Capital Gains & Dividends: 15%-20% Rates



Capital Gains and Qualified Dividends

- Stated capital gain rates (ignoring 3.8% NIIT):
  - 0% for taxpayers in 10% and 15% brackets
  - 15% for taxpayers in 25% to 35% brackets
  - 20% for taxpayers in 39.6% bracket
  - 25% for prior depr. on general farm bldgs.
  - 28% for gains on collectibles
- CAUTION: Immediate ordinary income depreciation recapture on bins, livestock barns, tiling, irrigation systems and wells

2012 ATRA: Phase-out of Itemized Reinstated

- 3% of overall itemized deduction phase-out (Pease limit)
- Reduces itemized deductions by 3% of AGI in excess of threshold levels
  - $300,000 Married filing joint
  - $250,000 Single
- Cannot reduce itemized deductions by more than 80%
- Effective rate increase is 1%
  - 1.188% for those in the 39.6% bracket; .99% for those in 33% bracket

2012 ATRA: Phase-out of Exemptions Reinstated

- Phase-out of personal exemption deductions for taxpayers with AGI above the same threshold level as the itemized reduction
  - Reduces personal exemption by 2% for each $2,500 (or portion thereof) by which AGI exceeds the threshold
  - Range is fixed at $125,000 (i.e., $2,500 divided by .02)
- Effective increase in tax rate varies based upon number of personal exemptions
  - 4.37% for 4 exemptions at 35% rate (about 1% per person)
  - Joint filers are fully phased out *before* being subject to the 39.6% bracket

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Phase-out Rate Illustrations: 2 Kids

	AGI w/2 kids	Rates
		Income + Item. + Ex.
Single	$250K – $375K	33% + 1% + 3% = 37%
Joint	$300K – $425K	33% + 1% + 4% = 38%

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New 3.8% Tax on Net Investment Income

- 3.8% surtax on net investment income (NII) of individuals effective in 2013, computed as the lesser of:
  - Net investment income, or
  - Excess of modified AGI over $200,000 single/$250,000 joint
- Definition of net investment income (NII)
  - Interest, dividends, annuities, royalties, rents
  - Passive business income and trading
  - Net gains from property (except active business)

    [All less allocable deductions]

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New 3.8% Tax on Net Investment Income

- Exceptions to investment income:
  - Material participation business income and gains, including gains from sale of S corp./partnership
  - Retirement plan distributions
  - Self-Employment income subject to SE tax
  - Tax-exempt income and nontaxable gains (e.g., residential gain exclusion)

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Pass-Through Owners Subject to the Tax

- All owners are subject to the NIIT on traditional pass-through investment income items
  - Interest, dividends, capital gains, royalties, etc.
  - Less allocable deductions
- Passive owners subject to NIIT on business income too
- Materially participating owners not subject to NIIT on income from activities in which they materially partcipate

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Farm Rents May Be Subject to NIIT

- Self-rental income not subject to NIIT if:
  - Farmer materially participates in entity renting the ground
  - Retired farmers should materially participate in the entity if possible
- Properly grouped rentals properties with material participation entities not subject to NIIT
- Re-grouping may be allowed in first year NIIT applies to the farmer

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Simplified Reporting of Gain

- If you sell an interest in a partnership (LLC) or S corporation, you are allowed to use simplified if:
  - Gain is less than $250,000, or
  - Gain is more than $250,000, but less than $5 million and your investment income is less than 5% of total income
    - ◊ Based on current year plus last two years
    - ◊ Losses are shown as positives for purposes of testing only
  - If you qualify, then you pick up your overall net investment income % from three years to total gain

Planning for the 3.8% Tax on NII

- Not a Medicare tax
- Not added to regular tax to help offset AMT
- Extra "sidebar" tax to pay for Health Care Act
- Sale of C corp. stock subject to tax, even if materially participate in the business
- Avoid spikes in income if can stay <$200K/$250K AGI

High Income Earner Medicare Tax

- Starting in 2013, additional 0.9% Medicare tax on wages/SE income > $200,000 single/$250,000 joint
  - $250,000 test on joint return considers both spouses in the aggregate
- An additional Medicare tax
  - Raises self-employed Medicare tax from 2.9% to 3.8% on upper income

Top Rate Thresholds

	Single	Joint
Earned Income		
• 0.9% Medicare tax	$200,000	$250,000
AGI		
• 3.8% NII tax	$200,000	$250,000
• Itemized & exemption phase-outs	$250,000	$300,000
Taxable Income		
• 39.6% income tax rate	$400,000	$450,000

2012 ATRA: Phase-out of deductions

- Marginal rate impact:
  - Itemized phase-out: Approx. 1%
  - Exemption phase-out: Approx. 1% per exemption
- Top ordinary rate in 2013: 44.59%
  - 39.6% + 3.8% NII (or 3.8% Medicare) + 1.19% itemized phase-out [completed personal exemption phase-out]
- At lower income levels ($250K jt. TI): 39.85%
  - 33% + 3.8% + .99% itemized + 2.06% (2 ex.)

Capital Gain Rates: Illustrations

	Joint; Family of 4	
Adj. Gross Income (AGI)	>$300K	
TI	>$223K	>450K
Capital gain rates:		
• Base rate	15.%	20.%
• NII tax	3.8%	3.8%
• Itemized phaseout	.99%	1.19%
• Exemption phaseout	4.118%	---
Total	23.908%	24.99%

Summary re Individual Tax Rates

- Marginal tax rate planning (i.e., the effective tax rate of additional income) now insanely complex
  - Will require running the software!
- Installment sales of land more favorable than pre-2013
  - Avoid 20% capital gain bracket (<$400K TI)
  - Avoid 3.8% NII tax (<$200K AGI)
- Farm income averaging to push income back to pre-2013 rates

Bonus Depreciation

- 2012's 50% bonus depreciation extended to assets placed in service during 2013
  - Calendar year provision; expires 12-31-2013
- Applies to "new" (i.e., original use) property only
- Cost recovery periods 20 years and shorter
- All farm depreciable assets ≤ 20 yrs.

Bonus Depreciation: Bouncing %

Acquired & Placed in Service	Bonus %
1/1/08 – 9/8/10	50%
9/9/10 – 12/31/11	100%
1/1/12 – 12/31/12	50%
1/1/13 – 12/31/13	50%
2014 and after	0%

- Same dates for all taxpayers, incl. fiscal yr. entities

Section 179 for 2012 and 2013

- Retroactively increased to $500,000 for tax years beginning in 2012 and 2013
  - Maximum applies unless taxpayer places in service more than $2 million of qualifying Section 179 property
  - No provision for tax years beginning after 2013
  - "Permanent" law lowers Sec. 179 ded. to $25,000 in 2014
  - This is for years beginning in 2012 and 2013, can be for year-ends up to November 30, 2014
    - ◊ Must be careful if too much flows through onto 2014 tax return
  - For the future, tax leases may make more sense than relying on Section 179 or bonus depreciation

Section 179 Amounts

Tax yr. beginning in	Sec. 179 Limit	Asset Addn. Phase-out Range
2009	$250,000	$800K - $1.05M
2010	$500,000	$2M - $2.5M
2011	$500,000	$2M - $2.5M
2012--prior	$139,000	$560K - $699K
2012 & 2013 ATRA	$500,000	$2M - $2.5M
2014	?	

(Best guess for '14: About $140,000)

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Ordering of Sec. 179 & 50% Bonus

		2013 Deduction
2013: Farm asset purchases	$700,000	
– Section 179 – first	(500,000)	$500,000
– Balance	$200,000	
– 50% bonus – second	(100,000)	100,000
– 7 yr. 1.5DB, ½ yr. on $100,000		10,714
Total 2013 Deduction		$610,714

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Depreciation of new assets in 2014

		2014 Deduction
2014: Farm asset purchases	$700,000	
– Section 179 – est.	(140,000)	$140,000
– Balance	$560,000	
– 50% bonus	(0)	
– 7 yr. 1.5DB, ½ yr. on $560,000		60,000
Total 2014 Deduction		$200,000

Small Ag Employers and the ACA

Topics

- Medical Reimbursement Plans: Out in 2014?
- The End of the Small Employer Health Care Credit
- Exchange Subsidies for Individuals
- The Pending Health Insurance Nondiscrimination Rules

Medical Reimbursement Plans

- MRPs: Sec. 105 plans or Health Reimbursement Arrangements (HRAs)
  - Concept: Reimburse employee out-of-pocket health costs and/or insurance premiums
  - Must be nondiscriminatory
  - Employer tax deduction
  - Employee tax-free fringe benefit per Sec.105
  - Two versions: HRA has a carryover feature; MRP is use-or-lose

Medical Reimbursement Plans

- Beginning in 2014, MRPs violate ACA "market reforms" [Notice 2013-54]
  - Employer group health plans must have unlimited benefits on specified services & no-cost preventive services (among other requirements)
  - Penalty: $100 per day per employee!
  - Employer pmt. of individual health ins. premium also violates market reforms
- Exceptions:
  - One-employee plans
  - Ancillary benefit plans
  - Integrated plans

Medical Reimbursement Plans

Exceptions to ACA market reform mandates:

- One-employee plans
  - Caution: Nondiscrimination rules apply
- Ancillary benefit plans
  - Cover dental, vision, LT care, or disability
  - These cannot cover health insurance, co-pays, hospital & doctor deductibles

Medical Reimbursement Plans

Exceptions to ACA market reform mandates

- 105 plans integrated with group health coverage
  - 105 plan is coordinated with group insurance
  - Coordinated coverage must meet ACA market reforms
  - Each participant in MRP must be enrolled in the health insurance plan [IRS Notice 2013-54]

Medical Reimbursement Plans

New taxes in 2014

- PCORI fee: $2 per covered individual for 2014 [Sec. 4376]
  - Report on IRS Form 720 due each July 31
- Reinsurance Program fee: $63 per enrollee
  - Begins in 2014
  - Report no. of enrollees to HHS by 11-15-14; they bill employer

Section 125 Plans

- These rules extend to Section 125 plans that allow employee to pay health insurance premiums on a pre-tax basis
- As of January 1, 2014, these plans are no longer allowed to have this benefit
  - Exception – Employers with less than 50 employees and provides group insurance via SHOP coverage through the public exchange
    - ◊ Some states do not have a SHOP set up yet, delay in implementation until they do

Summary

- In 2014 and thereafter, farmers precluded from subsidizing or reimbursing employees unless:
  - Provide a tax-free fringe benefit in the form of an ACA-provided group health plan
  - Treat any reimbursement of individual employee health insurance premiums as taxable compensation
  - Provide group insurance through the SHOP exchange and provide a Section 125 plan for employee pre-tax funding of any employee paid premiums

Small Employer Health Care Credit

Tax Yr. Beginning In	Taxable Employer	Tax-Exempt Employer
2010 – 2013	35%	25%
2014 – 2015	50%	35%

Credit limit:	Income Tax	Payroll tax

Credit calculation: % x Employer-paid premiums

Small Employer Health Care Credit Phase-outs

	Full Credit	Phase-out Range	No Credit
No. of FTEs	≤10	>10 - <25	≥25
Ave. Wages	≤$25K	>$25K - <$50K	≥$50K

Note: Each phase-out applied separately to gross credit

Small Employer Health Care Credit

- 2014: Credit % increases from 35% to 50%; but –
  - Employer must purchase insurance through an Exchange
  - Credit only available for first 2 consecutive yrs. of purchasing through Exchange [Sec. 45R(b)(1) and (e)(2)]
  - Farmers in states with no SHOP exchange can still take advantage of credit

Exchange Subsidies

- 2014: Refundable premium assistance tax credit for low and middle income individuals purchasing health insurance through an ACA exchange
- Multi-step process:
  - Purchase health insurance through exchange
  - Exchange pays portion of premium (advance pmt.) based on individual's estimate of income
  - Advance pmt. reconciled in Form 1040 [Sec. 36B]

Exchange Subsidies

Eligibility for subsidy/tax credit

- Household income ≤400% fed. poverty level
  - $46,000 individual
  - $62,000 household of two
  - $94,000 household of four
- Not enrolled in any employer health plan, including MRP
- Not eligible for an employer plan that is:
  - Affordable (premium under 9.5% of income) and
  - Minimum value (>60% actuarial benefit)

Exchange Subsidies

- Subsidy/credit on a sliding scale: Decreases as income increases from 100% to 400% FPL
  - Sliding scale for taxpayer premium: 2% - 9.5% of income
- Example: Married individual with 2 kids/$32,000 income/$9,700 premium for silver Exchange policy (2nd lowest premium):

Premium	$ 9,700
Affordable premium (3.17% x $32K)	(1,014)
Subsidy/credit	$ 8,686

Pending Group Health Nondiscrimination

- ACA adds nondiscrimination rules to employer-provided health plans
  - Violation: $100/day penalty per discriminated employee
- IRS delays compliance
  - Effective after future IRS regulations (2016? 2017?)
- Employers should consider future nondiscrim. rules when they weigh merits of retaining/ dropping employer health ins.

Small Employer Health Plans in 2014

<u>Summary</u>

- Employer pmt. of individual policy premiums and Sec. 105 MRPs violate ACA (big penalty)
- Group health plans in 2014 must meet ACA mandates
  - Premiums likely more costly (mandates on coverages)
  - Small employer credit only 2 yrs. and only if employer insurance thru Exchange
- Conclusion: Drop employer coverage??
  - Employees subsidized by Exchange/credit < 400% FPL
  - Owner claims 100% SE health insurance deduction for personal premium (unless C corp.)

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Tax Reform

- Both Senate and House have tax reform proposals issued in 2013
  - House – Dave Camp (R) –Chairman of House Ways and Means Committee
  - Senate – Max Baucus (D) – Chairman of the Senate Finance Committee

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The End of Cash Method of Accounting?!

- House:
  - If you are a sole proprietor – You can retain cash method
  - Any other entity can retain cash method until three-year average cash receipts exceed $10 million
  - Related party rules apply
- Senate
  - Essentially same provisions as House except sole proprietors would be subject to same rules
- Index to inflation ($1 million mimimum)
- 4 year spread of income (have to wait four years to switch back)

Section 179

- Would raise maximum Section 179 to $1 million
  - Made permanent
  - Indexed to inflation
  - Other items would be included in qualified assets

Depreciation Proposals

- New pooling system (Senate)
  - Four classes of assets
    - ◊ No individual tracking of assets
    - ◊ 38%, 18%, 12%, 5%
      - Most farm equipment would be in pool 2 (18%)
      - Could take 20-30 years to fully depreciate assets
  - Real Property depreciated over 43 years
    - ◊ Includes 10 year single purpose Ag structures
    - ◊ Retroactive application
  - No Section 1231 gain on sale of raised breeding stock or other farm assets
    - ◊ No special capital gains treatment
    - ◊ No self-employment tax savings

Other Proposals

- Eliminate automatic fertilizer deduction
  - Would need to deduct as fertilizer is used
    - ◊ Record keeping nightmare?
- Half of Advertising expenses are amortized over five years
  - Can take Section 179 on these expenses
- Intangible assets are amortized over 20 years instead of 15

Tax Strategies

- Thanks for attending!
- Questions??
- Contact Info
  - Paul Neiffer, CPA
  - 509-823-2920 (direct line)
  - 509-961-9739 (mobile line)
  - Paul.neiffer@claconnect.com