

# ELLIS & ELLIS, CPAS, INC.

## TAKING ON TAXES

### START 2015 TAX PLANNING NOW

#### Tax Code Changes Create Challenges

**THE DREAMS MAGAZINE:** What should small business owners focus on for 2015 tax planning?

**DAVID ELLIS:** An important, yet often overlooked, issue for small business owners is the choice of the form of entity under which they operate. For 2015, this will become critical as Congress contemplates major changes to the tax code. Currently, the maximum corporate federal tax rate is generally less than the maximum individual tax rate. This has led many business owners to consider converting their sole proprietorships and pass through entities (such as S corporations and LLCs) into C corporations, which are taxed at the lower corporate rate. Caution must be exercised before making this change, since C corporations have their own set of prickly tax thorns. Issues such as lack of a favorable capital gains tax rate on the sale of business assets, officers' compensation and double taxation on dividend profits all need to be considered.

For those businesses that are operating as LLCs, owners need to be aware that any LLC member who performs services to the LLC will, under a new IRS ruling, now be subject to self-employment tax at a whopping 15.3%. (See IRS Chief Counsel Advice 201436049).

We think that the best thing business owners can do tax-wise for now is to stay flexible and watch developments in Washington closely.

**THE DREAMS:** What should partners who married under California's Equal Marriage Law be concerned about or plan for in terms of taxes?

**ELLIS:** Same sex marriage is now recognized in California. This means, from a tax perspective, same sex married couples face the same issues as opposite sex couples. They are also eligible to take advantage of what we call the "biggest tax loophole of all time" – the double step-up in basis on community property.

This is a section of the tax code that stipulates when property is held as community property and one spouse dies, the appreciation on the property is not taxed to the surviving spouse when he/she disposes of the property. For example, suppose Fred and Barney bought their house in 1969 for \$37,000 and titled it as community property. Let us say that today it has a fair market value of \$650,000. Were Fred to pass away, the house would assume a stepped-up tax basis (for income tax purposes – not property tax) of \$650,000.

Assuming Barney sold the house the next day for \$650,000, he could pocket the entire \$650,000 without paying a penny in federal or state income tax. These rules apply to any community property asset (i.e. stocks, investment property, etc.) owned by a married couple regardless of the increase in value,

so even if Barney sold the house for \$20 million, all of the gain would still be tax free.

The bottom line is same sex married couples should consider retitling property from joint tenancy to community property for estate planning purposes. One note of caution, what is good for avoiding estate taxes, may not be so good in the event of a divorce.

**THE DREAMS:** Inheritance taxes and estate planning are a growing concern for affluent baby boomers. What are some of the major issues?

**ELLIS:** In addition to the double step-up in basis on community property discussed above, the baby boom generation will benefit from some of the most generous estate tax loopholes in history. For example, married couples have complete spousal exemption from estate and gift tax when transferring property to each other. This has not always been the case.

For 2015, every person has a lifetime net gift and estate tax exemption up to \$5.43 million. Considering that the top gift and estate tax rate is 40%, this exemption represents an enormous tax savings. Even better, under a recently introduced tax provision known as portability, when one spouse dies, the unused portion of his/her \$5.43 million exemption can be transferred to the surviving spouse for his/her use in negating gift or estate tax. Thus, as a practical matter, a married couple as of 2015 can shelter \$10.86 million in transferred property from gift and estate tax quite easily. Note: Portability is not automatic. The surviving spouse must elect it by filing form 706 very soon after the death of the first spouse.

**THE DREAMS:** How do you work and coordinate with attorneys and financial planners?

**ELLIS:** We make it a point to communicate with the client's attorney and financial planner anytime we see anything of financial or legal significance that has happened or is likely to happen. For example, in some cases, by combining the estate and gift tax exemption with the proper use of certain irrevocable trust, millions of dollars in estate and gift taxes may be avoided. If we see that a client may potentially benefit from this type of strategy, we will work closely with his/her attorney and financial planner to implement a plan.

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David Ellis, the managing partner of Ellis & Ellis, CPAs, Inc. located in Pasadena, California, has more than 25 years of experience in the practice of divorce, trust/estate and other family tax matters. He is an advisor to the Los Angeles County Office of the Public Guardian on matters pertaining to trust, estate and corporate taxation. The firm also provides IRS representation and other general tax services.

David earned his bachelor's degree from the University of Southern California in communication arts and sciences. A frequent writer and speaker on various tax subjects, he has provided continuing education services to other CPAs and tax professionals in the area of divorce, trusts and estate taxation.

David recently co-authored an article titled "The Tax Consequences of Dividing Marital Property," which can be found in the December 2014 issue of *Practical Tax Strategies*, a national professional tax publication.



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