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# Leslie A. Cesario, Ltd.
# Monthly Newsletter

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## Mid-Year Tax Planning Checklist

All too often, taxpayers wait until after the close of the tax year to worry about their taxes and miss opportunities that could reduce their tax liability or financially assist them. Mid-year is the perfect time for tax planning. The following are some events that can affect your tax return; you may need to take steps to mitigate their impact and avoid unpleasant surprises after it is too late to address them.

- ❑ Did you get married, divorced, or become widowed?
- ❑ Did you change jobs or has your spouse started working?
- ❑ Did you have a substantial increase or decrease in income?
- ❑ Did you have a substantial gain from the sale of stocks or bonds?
- ❑ Did you buy or sell a rental?
- ❑ Did you start, acquire, or sell a business?
- ❑ Did you buy or sell a home?
- ❑ Did you retire this year?
- ❑ Are you on track to withdraw the required amount from your IRA (age 70.5 or older)?
- ❑ Did you refinance your home or take out a second home mortgage this year?
- ❑ Were you the beneficiary of an inheritance this year?
- ❑ Did you have a child? Time to consider a tax-advantaged savings plan!
- ❑ Are you taking advantage of tax-advantaged retirement savings?
- ❑ Have you made any significant equipment purchases for your business?
- ❑ Are you planning to purchase a new business vehicle and dispose of the old one? It makes a significant difference whether you sell or trade-in the old vehicle.
- ❑ Are your cash and non-cash charitable contributions adequately documented?
- ❑ Are you keeping up with your estimated tax payments or do they need adjusting?
- ❑ Did you purchase your health insurance through a government insurance exchange and qualify for an insurance subsidy? If your income subsequently increased, you may need to be prepared to repay some portion of the subsidy.
- ❑ Do you have substantial investment income or gains from the sale of investment assets? If so, you may be hit with the 3.8% surtax on net investment income and need to adjust your advance tax payments.
- ❑ Did you make any unplanned withdrawals from an IRA or pension plan?
- ❑ Have you stayed abreast of every new tax law change?

If you anticipate or have already encountered any of the above events or conditions, it may be appropriate to consult with this office—preferably before the event—and definitely before the end of the year.

## Reap the Tax Benefits of Education Planning

**Article Highlights:**

- Education financing
- American Opportunity Credit
- Lifetime Learning Credit

- Coverdell Education Savings Account
- Qualified Tuition Programs (Sec 529 Plans)
- Savings Bond program

The tax code includes a number of incentives that, with proper planning, can provide tax benefits while you, your spouse, or your children are being educated.

**Education Financing:** A major planning issue is how to finance your children's college education. Those with substantial savings simply pay the expenses as they go, while some parents, sometimes with the help of the children's grandparents, begin setting aside money far in advance of the education need, perhaps utilizing a Coverdell account or Sec. 529 plan. Other parents or their student-children will need to borrow the funds, obtain financial aid, or be lucky enough to qualify for a scholarship. Although student loans provide one ready source of financing, the interest rates are generally higher than a home equity loan, which can also provide a longer term and lower payments. When choosing between a home equity loan or a student loan, keep in mind the following limitations: (1) Interest on home equity debt is deductible only if you itemize and then only on the first $100,000 of debt, and not at all to the extent you are taxed by the alternative minimum tax; and (2) student loans must be single-purpose loans; the interest deduction is limited to $2,500 per year, and the deduction phases out for joint filers with income (MAGI) between $130,000 and $160,000 ($65,000 to $80,000 for unmarried taxpayers, and no deduction if filing married separate).

**Education Tax Credits:** The tax code also provides tax credits for post-secondary education tuition paid during the year for the taxpayer and dependents. There are two types of credits: the American Opportunity Credit, which is available through 2017 and is limited to the first four years of post-secondary education, and the Lifetime Learning Credit which provides credit for years after the first four years of post-secondary schooling and can be used for graduate studies.

The American Opportunity Credit, in many cases, offers greater tax savings than other existing education tax breaks! Here are some key features of the credit:

- Tuition, related fees, books, and other required course materials generally qualify. The credit is equal to 100 percent of the first $2,000 of education expenses and 25 percent of the next $2,000. This means the full $2,500 credit may be available to a taxpayer who pays $4,000 or more in qualified expenses for an eligible student.
- The full credit is available for taxpayers whose modified adjusted gross income (MAGI) is $80,000 or less (for married couples filing a joint return, the limit is $160,000 or less). The credit phases out for taxpayers with incomes above these levels. These income limits are higher than those for the Lifetime Learning Credit.
- Forty percent of the American Opportunity Credit is refundable. This means that even people who owe no tax can get an annual payment of the credit of up to $1,000 for each eligible student. Other existing education-related credits and deductions do not provide a benefit to people who owe no tax. The refundable portion of the credit is not available to any student whose investment income is taxed at the parent's rate, commonly referred to as the "kiddie tax."

The Lifetime Learning Credit provides up to $2,000 of credit for <u>each family</u> each year. The Lifetime Learning Credit is phased out for joint filers with incomes (MAGI) for 2014 between $108,000 and $128,000 ($54,000 to $64,000 for single filers) and is not allowed at all for married individuals filing separately.

Careful planning for the timing of tuition payments can provide substantial tax benefits. Taxpayers are allowed to prepay the first three months of the subsequent year's tuition in advance, thereby allowing them to spread the payment and maximize the credits.

**Tax-Favored Savings Programs:** For those who wish to establish a long-term savings program to provide funds to educate their children, the tax code provides two plans. The first is a Coverdell Education Savings Account, which allows the taxpayer to make $2,000 annual nondeductible contributions to the plan. The second plan is the Qualified Tuition Plan, more frequently referred to as a "Sec. 529 plan," with annual contributions generally limited to the gift tax exemption amount for the year ($14,000 in 2014). However, the law allows up to five years of a contributor's contributions to be made to a Sec. 529 in a year without gift tax implications, allowing substantial up-front contributions.

Both plans provide tax-free earnings if they are used for qualified education expenses. When choosing between a Coverdell or Sec. 529 plan, keep the following in mind: (1) Coverdell accounts can be used for kindergarten through post-secondary education and become the property of the child at the age of majority, and contributions phase out for joint filers with income (MAGI) between $190,000 and $220,000 ($95,000 and $110,000 for others); and (2) Sec. 529 plans are only for post-secondary education, but the contributor retains control of the funds.

**Savings Bond Program:** There is also an education-related exclusion of savings bond interest for Series EE or I Bonds purchased by an individual over the age of 24. All or part of the interest on these bonds is exempt from tax if qualified higher education expenses are paid in the same year the bonds are redeemed. As with other benefits, this one also has a phase-out limitation for joint filers with income (MAGI) between $113,950 and $143,950 (between $76,000 and $91,000 for unmarried taxpayers, but those using the married separate status do not qualify for the exclusion). The income ranges shown are for 2014. If you would like to work out a comprehensive plan to take advantage of these benefits, please give this office a call.

## Scammers Getting More Brazen

**Article Highlights:**

- Taxpayers Receiving Bogus Call from Individuals Claiming To Be IRS Agents.
- Guidelines to Avoid Being a Victim of a Scam or ID Theft.
- Limit Accounts to Avoid ID Theft Exposure.

We have previously cautioned you not to be duped by Internet and mail scams dreamed up by some pretty enterprising thieves. Most of those revolve around the Internet and e-mails, trying to steal your identity or have you pay tax liabilities that don't exist.

The latest schemes revolve around phone calls from individuals claiming to be IRS agents who demand immediate payment for fabricated tax liabilities. Don't get caught up in these scams. Always remember, the first contact you will receive from the IRS is letter, never a phone call or e-mail.

Here are some guidelines to follow to avoid becoming a victim:

1. **First and foremost**, always remember, the first contact you will receive from the IRS will be by U.S. mail. If you receive e-mail or a phone call claiming to be from the IRS, consider it a scam.
    a. **E-mails** – Do not respond or click through to any embedded links. Instead, forward it to phishing@irs.gov**.**
    b. **Phone calls** – If someone calls claiming to be an IRS agent, ask for their name, badge number, and phone number. Tell them your representative will call them back. Then call this office.

2. Never provide financial information over the phone via the Internet, or by e-mail unless you are absolutely sure with whom you are dealing. That includes:
   - _Social Security Number_ – Always resist giving your Social Security number to anyone. The more firms or individuals who have it, the greater the chance it can be stolen.
   - _Birth Date_ – Your birth date is frequently used as a cross check with your Social Security Number. A combination of birth date and Social Security number can open many doors for ID thieves. Is your birth date posted on social media? Maybe it should not be! That goes for your children, as well.
   - _Bank Account and Bank Routing Numbers_ – This along with your name and address will allow thieves to tap your bank accounts. To counter this threat, many banks now provide automated e-mails alerting you to account withdrawals and deposits.
   - _Credit/Debit card numbers_ – Be especially cautious with these numbers, since they provide thieves with easy access to your accounts.

There are individuals whose sole intent is to steal your identity and sell it to others. Limit your exposure by minimizing the number of charge and credit card accounts you have. The more who have your information, the greater the chances of it being stolen. Don't think all the big firms are safe; there have been several high-profile database breaches in the last year.

The IRS is not the only disguise scammers use. They pretend to be attorneys representing estates, lottery payouts, and other such subterfuge to draw you into their web. If you ever have questions related to suspect e-mails or phone calls, please call this office before responding to them.

## The Alimony Gap

**Article Highlights:**

- Alimony is deductible to the payer.
- Alimony is income for the recipient.
- The IRS matches alimony deductions and income by SSN.
- Alimony is often confused with child support payments.
- Audits can lead to filing penalties.

Individuals who pay alimony can deduct the amount paid from income on their tax return to reduce the amount of their personal income tax. Conversely, individuals who receive alimony must claim the amount received as income on their tax returns.

Recently, the Treasury Inspector General reported that for approximately half of all returns filed on which an alimony deduction was claimed, there were significant discrepancies in reporting the corresponding amount of taxable alimony received.

Why does this happen? The primary reason is probably because of a misunderstanding of what constitutes alimony. For divorce, support and separation decrees and agreements made after 1984, the definition of alimony includes six attributes that define when payments are in fact alimony. To be alimony, the payments:

1. **Must be in cash**, paid to the spouse, ex-spouse or a third party on behalf of a spouse or ex-spouse;

2. **Must be required** by a decree or instrument incident to divorce, a written separation agreement or a support decree;
3. **Cannot be designated as child support**;
4. **Only count if the taxpayers are living apart after the decree** (spouses who share the same household cannot qualify for alimony deductions—this is true even if the spouses live separately within the dwelling unit);
5. **Must end on the death of the payee (recipient)**; and
6. **Cannot be contingent on the status of a child** (that is, any amount that is discontinued when a child reaches 18, moves away, etc., is not alimony).

Payments need not be for support of the ex-spouse or based on the marital relationship. They can even be payments for property rights as long as they meet the above requirements. Payments need not be periodic, but there are dollar limits and "recapture" provisions. Even if payments meet all of the alimony requirements, the couple may designate in their agreement or decree that the payments are not alimony, and that designation will be valid for tax purposes.

One of the main sources of discrepancies lies with the distinctions between child support and alimony. For example, an individual is required to pay $1,500 per month to a former spouse, with the provision that the payment decreases to $1,000 per month when the couple's child reaches age 18. In this situation (see #6 above), the alimony is only $1,000, and the $500 is nondeductible/nontaxable child support.

Reporting the incorrect amount will undoubtly lead to an IRS inquiry since the one making the alimony payment must include the Social Security Number (SSN) of the recipient, and the IRS computer matches the income and deduction reported on the respective tax returns. A resulting examination could end with the assessment of tax and filing penalties for the individual declaring the incorrect amount. If the alimony payer reports an invalid recipient SSN, or fails to include it altogether, the IRS may assess a penalty, even if the recipient has properly reported the alimony income.

Those receiving alimony may not be aware that alimony is treated as earned income for purposes of making IRA contributions.

If you are concerned that the amount you are declaring or deducting as alimony might be incorrect, or are currently involved in a divorce action, and would like to understand the tax ramifications of alimony, child support and who will receive the tax benefits provided for your children, please call this office.

## Beware of Trust Fund Penalties

### Article Highlights

- Trust fund penalty
- Employers can be held personally liable
- Responsible persons of a corporation or limited liability firm can be held personally liable
- Factors used in determining a liable responsible person

The term "trust fund recovery penalty" refers to a tax penalty assessed against the directors or officers of a business entity that failed to pay a required tax on behalf of its employees. For example, employers withhold income taxes and FICA payroll taxes from employees' wages. These funds actually belong to the government and are referred to as "trust funds."

They cannot be used by the employer to pay other business expenses.

Tax law provides that employers are personally responsible for remitting the trust funds to the government. If the employer is a business entity such as a corporation or a limited liability company, then any person who was "required to collect, truthfully account for, and pay over" the funds is liable "for a penalty equal to the total amount of tax" that went unpaid. Once assessed, these "trust fund penalties" cannot be discharged in bankruptcy, and the employer or responsible person(s) will be liable for them even if the business entity itself is liquidated. Other civil penalties, as well as criminal penalties, could also apply.

The trust fund recovery penalty (the amount of the tax that was collected and not paid) can be imposed on any person who:

(1) Is responsible for collecting, accounting for, and paying over payroll taxes; and

(2) Willfully fails to perform this responsibility. Willfulness involves a voluntary, conscious and intentional act to prefer other creditors over the U.S. Thus, if a responsible person knows that withholding taxes are delinquent and uses corporate funds to pay other expenses, such failure to pay withholding taxes is deemed "willful."

In determining whether an individual is a responsible person, courts consider various factors, including whether the individual:

(1) Holds corporate office;

(2) Has check-signing authority;

(3) Can hire and fire employees;

(4) Manages the day-to-day operations of the business;

(5) Prepares payroll tax returns;

(6) Signs financing contracts; and

(7) Determines financial policy.

If you can be judged to be a responsible person, make sure the trust fund payments are made before any other expenses are paid, even if encouraged not to do so by someone else of authority within the company.

Otherwise you may be held responsible for the unpaid funds, and the liability could follow you to your grave. If you have questions about the trust fund rules and potential penalties, please give this office a call.

**Tax Tips for Recently Married Taxpayers**

This is the time of year for many couples to tie the knot. If you marry during 2014, here are some post-marriage tips to help you avoid stress at tax time.

1. **Notify the Social Security Administration** – Report any name change to the Social Security Administration so that your name and SSN will match when filing your next tax return. Informing the SSA of a name change is quite simple. File a *Form SS-5, Application for a Social Security Card* at your local SSA office. The form is available on SSA's Web site, by calling 800-772-1213, or at local offices. Your income tax refund may be delayed if it is discovered your name and SSN don't match at the time your return is filed.

2. **Notify the IRS** – If you have a new address, you should notify the IRS by sending Form 8822*, Change of Address*.
3. **Notify the U.S. Postal Service** – You should also notify the U.S. Postal Service when you move so that any IRS or state tax agency correspondence can be forwarded.
4. **Review Your Withholding and Estimated Tax Payments** – If both you and your new spouse work, your combined income may place you in a higher tax bracket, and you may have an unpleasant surprise when we prepare your return for 2014. On the other hand, if only one of you works, filing jointly with your new spouse can provide a significant tax benefit, enabling you to reduce your withholding or estimated payments. In either case, it may be appropriate to review your withholding (W-4 status) and estimated tax payments, if any, for 2014 to make sure that you are not going to be under-withheld and that you don't set yourself up to receive bad news for the next filing season.

If you have any questions about the impact of your new marital status on your taxes, please give this office a call.

## Child Care Credit Available to Student-Parents

**Article Highlights:**

- Student Parents May Qualify for Child Care Credit
- Determining the Artificial Income for Credit Computation
- How the Credit Is Determined

If your family is among the many families that incur child care expenses so that a parent can attend school, you may be eligible for a child care tax credit. Generally, the child care credit is only available to couples where both parents work, but a special provision of the tax law permits married parents attending college to also get the credit, if they meet certain criteria, even if the student-parent has no income.

Normally, the child care credit is based on care expenses for children under the age of 13 (limited to $3,000 for one child and $6,000 for two or more) and further limited to the lesser of (1) the taxpayer's earned income, (2) the spouse's earned income, or (3) the actual child care expenses. If one of the spouses does not have an income, then no credit would be available, thus penalizing families where one parent is attending school full time with no earned income. To correct this inequity, the tax law includes a special provision for spouse-students.

| Artificial Income | | |
|---|---|---|
| Months | 1-Child | 2-Children |
| 5 | 1,250 | 2,500 |
| 6 | 1,500 | 3,000 |
| 7 | 1,750 | 3,500 |
| 8 | 2,000 | 4,000 |
| 9 | 2,250 | 4,500 |
| 10 | 2,500 | 5,000 |
| 11 | 2,750 | 5,500 |
| 12 | 3,000 | 6,000 |

To qualify for this tax break, the student-parent must be a full-time student for some part of five months during the year (the months don't have to be consecutive). For each month the student-parent qualifies as a full-time student, their earned income is *considered* to be the greater of $250 ($500 if the care is for two or more children) or their actual earned income for that month. If the student-parent is a full-time student for the entire year, the artificial income would be $3,000 for one child and $6,000 for two or more, permitting the student-parent the maximum allowable child care credit. This phantom income is used only for computing the child care credit and doesn't become income that is taxed.

The actual credit is based upon the taxpayer's income (AGI). For incomes between zero and $43,000, the credit ranges from 35% to 21%. For incomes above $43,000, the credit is 20%. The credit will reduce both income tax and the alternative minimum tax, but it is not refundable.

**For example**, a couple has two children under the age of 13. One spouse works full time and earns $45,000 a year. The other spouse attended college full time for nine months during the year and was not employed. Their annual child care expenses for the two children are $5,000. The student-spouse's artificial income (from the chart) is $4,500. The couple's child care credit is computed based upon the artificial earned income $4,500, since it is less than the actual expenses of $5,000 and the expense limitation is $6,000 for two children. Assuming the couple met all the other care qualification criteria, their credit would be $900 (20% of $4,500).

This article focused on the special full-time student provisions of the child care credit. There are also special provisions that apply for the care of a disabled spouse. If you have questions regarding these special provisions or any provision of the child and dependent care credit, please call.

**A Tour through QuickBooks' Payroll Setup Tool**

*Getting QuickBooks ready to process payroll is a complex, time-consuming process. Here's what you can expect.*

*Payday.* You look forward to it when you're young and working at your first part-time job.

But as a grown-up who needs to start processing payroll for your employees, you probably anticipate it in a different way, perhaps even with a sense of dread. QuickBooks handles the real grunt work once you've done the initial setup, but those early hours you spend preparing to print your first paycheck can be challenging.

Fortunately, QuickBooks' payroll setup tool can guide you through the process. Once you've signed up for payroll, open the **Employees** menu and select **Payroll Setup**.


*Figure 1: The **QuickBooks Payroll Setup** tool tells you'll what information you need to supply in order to start paying employees.*

**Easy Operations**
The first screen you'll see in this step-by-step, wizard-like setup guide contains a link to QuickBooks' **payroll setup checklist**. You don't have to assemble all of the information you'll need about your company, your employees, and your payroll taxes, but we recommend that you gather as much as you can before you start.

You'll advance through setup by completing the information requested and then clicking the **Continue** button in the lower right (or, sometimes, **Next**; there's also a **Previous** button available often). If you don't have a particular detail immediately at hand, you can continue on and come back later. You'll be able to edit your work then.

To back out of the whole process and return at another time, click the Finish Later button in the lower left.

**Building a Framework**
QuickBooks first wants to know about the various types of compensation and employee benefits your company offers. To start adding your **Compensation** options, click **Add New**. Click in the box in front of any pay types you support (**Salary, Hourly wage and overtime, Commission**, etc.) to create a check mark. When you click **Next**, this window opens:

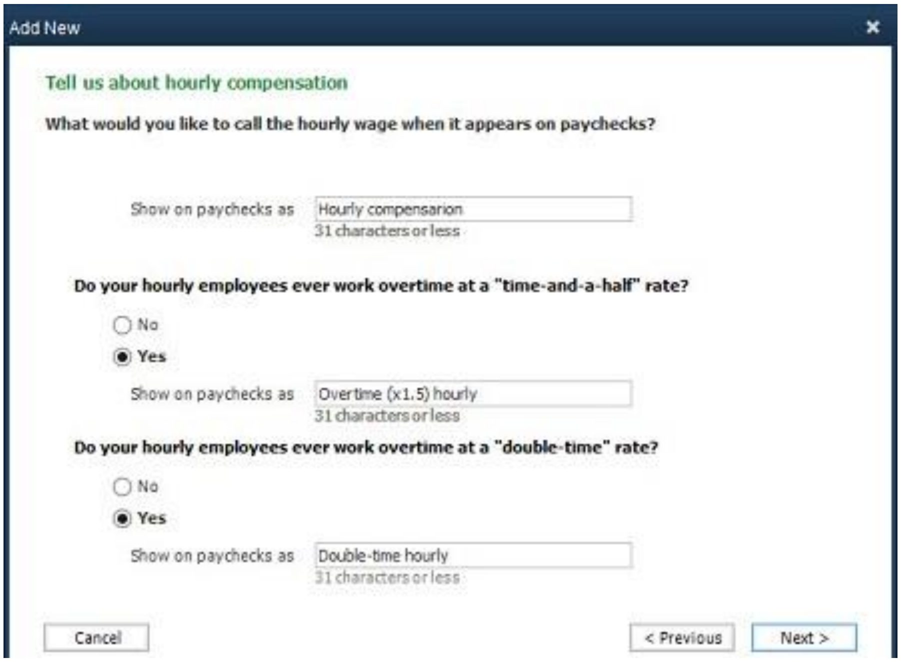


*Figure 2: It's easy to indicate the types of compensation your company offers.*

Keep clicking **Next** after you've completed each screen until you come to a page that lists all of the compensation types you've defined. To make any changes, highlight the type and click **Edit** to modify or **Delete** to remove. Then click**Continue** when you're finished.

The next section is probably the most difficult: Employee Benefits. Here, using similar interface conventions to enter information and navigate, you'll provide information about your company's:

- Insurance benefits
- Retirement benefits
- Paid time off, and
- Miscellaneous items (cash advance, wage garnishment, mileage reimbursement, etc.).

It's absolutely critical that you set these up accurately, or you'll have unhappy benefits providers – and employees. If you're not absolutely confident of an answer, it's better to leave an item unfinished and come back later. You may want to ask us to work with you as you complete this section.

**People and Taxes**
QuickBooks will then ask you about your employees. Have your W-4 forms handy for this section, as you'll need to know Social Security numbers, birth dates, etc.


*Figure 3: On this screen, you'll tell QuickBooks what type(s) of compensation and their dollar amounts apply to the employee.*

All of those details you entered earlier about company benefits comes into play here. Once you've defined an employee's compensation types and amounts, the next screen will display the additions and deductions that your company supports. You will have set up defaults for some of these, but you can modify them for individual employees.

There are numerous other details that you'll have to supply for your staff, like how vacation and sick hours accrue, what state will want to collect taxes from them, and what their filing status is.

Unless you've worked with payroll before, you're going to want our help in completing the payroll tax section. Once it's done correctly, QuickBooks will calculate taxes due and help you pay them.

Finally, QuickBooks helps you determine whether you'll need to enter any previous payroll data from the current year before you start to process your payroll in the software.

Whether you're switching from manual payroll or a payroll service, or simply getting ready to pay your first employee, QuickBooks payroll-processing tools can help you save time and foster accuracy – as long as you get the details from the start.