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Leslie A. Cesario, Ltd.
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Obamacare Adds New Levels of Complexity to Tax Returns

Article Highlights:

- New tax return complexities caused by Obamacare
- Penalty for not being insured
- Premium assistance credit
- Insurance marketplace subsidies and possible repayments
- New 1095 series reporting forms

Obamacare – or, more officially, the Affordable Care Act (ACA) – insurance mandate, along with its health insurance premium subsidies available from insurance marketplaces, premium tax credit (PTC), and penalty for not being insured, is going to affect just about every taxpayer in one way or another.

It is important for everyone to understand that new, substantial, and sometimes complicated reporting requirements have been added to the 2014 tax return to facilitate the ACA insurance mandate. As a result, taxpayers need to be prepared for a variety of new forms they will be receiving starting in January 2015 from their insurance companies, employers, and the marketplace that they will need in order to prepare their tax returns.

These forms, which are also filed with the government, will:

- Provide proof of ACA acceptable monthly insurance coverage for all family members that you will use on your 2014 tax return to avoid being assessed a penalty for not being insured.
- Provide the government, and you, with the amount of monthly advance premium tax credit (APTC) – sometimes referred to as a premium subsidy – you may have benefited from if you purchased health insurance from a government-run insurance marketplace (also known as an exchange). These amounts are needed to determine if you are entitled to an additional PTC or if you must repay some portion of the APTC. The insurance marketplaces will provide this information on a Form 1095-A. Private insurance companies will provide proof of coverage on Form 1095-B.

Things can get pretty complicated if your tax family or household income changed during the year and you did not report the change to the marketplace. When a taxpayer was married or divorced during the year or an individual who is not in your tax family was included in insurance purchased through the marketplace, the insurance premiums and APTC must be allocated among those insured by the month.

To make matters worse, the IRS is letting both employers and insurance companies use alternative means of providing the required information for 2014, which means you will need to watch out for substitute reporting not included on the official IRS forms.

All of this additional reporting and allocating, if necessary, greatly adds to the complexity of 2014 tax returns, especially for taxpayers who qualify for the PTC and those who’ve received APTC through the marketplace. If you have friends or family members who may need assistance with this new tax return complexity, please suggest they contact this office.

Health Savings Accounts Offer Tax Breaks

Article Highlights:

- Health Saving Accounts Tax Breaks
- Eligibility
- Contribution Limits
- Example

A health savings account (HSA) is a trust account into which tax-deductible contributions can be deposited by qualified taxpayers who have high-deductible medical insurance plans. These accounts are set up at a bank or other financial institution. Income earned on the HSA balance is income tax-free. The funds from these accounts are then used to pay qualified medical expenses not covered by an eligible individual's medical insurance. If these funds are not used, they roll over year to year. At age 65, the funds can be used like a retirement plan (taxable when withdrawn, but not subject to a withdrawal penalty) or continue to be saved for future medical expenses. Since the contribution is an above-the-line deduction, a taxpayer need not itemize to take advantage of this tax break. The rules discussed here are applicable to federal tax returns and may not apply to your particular state.

Who qualifies for an HSA? An eligible individual is one who is covered by a high-deductible plan (defined below) and, while covered by that high-deductible plan, is not also covered by another plan that does not have a high deductible. For purposes of determining if there is coverage that does not have a high deductible, the law allows certain types of coverage such as worker's compensation, insurance for a specific condition, dental care, vision, long-term care, and certain others to be disregarded.

Any eligible individual, whether employed, unemployed or self-employed, may contribute to an HSA. Unlike IRAs, there is no requirement that the individual have compensation and there are no phase-out rules for high-income taxpayers.

High-deductible Plans – For 2014, high-deductible plans are defined as those with the following deductible amounts:

- o <u>Self-only coverage</u> with an annual deductible of $1,250 or more and limits on annual expenses, other than premiums, required to be paid by the plan during the year, up to $6,350; or
- o <u>Family coverage</u> with an annual deductible of $2,500 or more and limits on annual expenses, other than premiums, required to be paid by the plan during the year, up to $12,700.

- **Qualified Medical Expenses** – Qualified medical expenses that can be paid from these accounts are generally defined as those that would be allowable as a medical deduction on your tax return.
- **Contribution Limits** - The eligibility and contribution amounts for these accounts are determined monthly. Therefore, during any month in which you qualify, you would be entitled to contribute 1/12 of the annual limits. However, an eligible individual who establishes an HSA plan during the year and is still an eligible individual during the last month of the year (December) can contribute the full-year amount (does not need to prorate the contribution). For 2014, the annual limits (note these values are adjusted annually for inflation) are:
    - o $3,300 for single coverage plans;
    - o $6,550 for family coverage plans; and

- $1,000 additional for individuals age 55 or older.

Individuals entitled to benefits under Medicare and those claimed as a dependent on another person's tax return cannot make contributions. Contributions can be made as late as the due date of the tax return without extensions, and contributions in excess of the allowable amounts are subject to an annual 6% excise penalty.

If you are eligible for an HSA and your employer contributes to your HSA, the contributions (within the limits) are treated as employer-provided coverage for medical expenses under an accident or health plan and are excludable from your gross income. They are not subject to income tax or FICA withholding (or FUTA tax). If contributions to your HSA are made through your employer's cafeteria plan, the contributions are treated as employer contributions. An employee may not deduct the employer's HSA contributions as either an HSA contribution or a medical expense on his or her return.

***Example**: John, a single taxpayer, age 58, begins a high-deductible health plan with an annual deductible of $5,000 in March of 2014. He continues in the plan through the end of the year. He may set up an HSA, and is eligible to contribute the full year's maximum of $4,300 ($3,300 plus $1,000 for being over 55) since he was in the high-deductible health plan in December. John's employer does not contribute to the HSA. When John files his 2014 tax return, he claims an above-the-line deduction of $4,300. If John were in the 25% tax bracket, he would realize a tax savings of $1,075.*

In January of 2015, John has $800 worth of medical expenses that are not covered by his health plan, so he withdraws $800 from his HSA to pay for them. The $800 distribution is not taxable income, but he can't include the $800 as a medical expense for itemized deductions.

If you have questions related to health savings accounts, please give this office a call.

When Can You Dump Old Tax Records?

Article Highlights:

- General statute is 3 years
- Some states are longer
- Fraud, failure to file and other issues can extend the statute
- Keeping the actual return

Taxpayers often question how long records must be kept and the amount of time IRS has to audit a return after it is filed.

It all depends on the circumstances! In many cases, the federal statute of limitations can be used to help you determine how long to keep records. With certain exceptions, the statute for assessing additional tax is 3 years from the return due date or the date the return was filed, whichever is later. However, the statute of limitations for many states is one year longer than the federal limitation. The reason for this is that the IRS provides state taxing authorities with federal audit results. The extra time on the state statute gives states adequate time to assess tax based on any federal tax adjustments.

In addition to lengthened state statutes clouding the recordkeeping issue, the federal 3-year rule has a number of exceptions:

- The assessment period is extended to 6 years instead of 3 years if a taxpayer omits from gross income an amount that is more than 25 percent of the income reported on a tax return.

- The IRS can assess additional tax with no time limit if a taxpayer: (a) doesn't file a return; (b) files a false or fraudulent return in order to evade tax; or (c) deliberately tries to evade tax in any other manner.
- The IRS gets an unlimited time to assess additional tax when a taxpayer files an unsigned return.

If no exception applies to you, for federal purposes, you can probably discard most of your tax records that are more than 3 years old; add a year or so to that if you live in a state with a longer statute.

Examples: Susan filed her 2013 tax return before the due date of April 15, 2014. She will be able to safely dispose of most of her records after April 15, 2017. On the other hand, Don filed his 2013 return on June 1, 2014. He needs to keep his records at least until June 1, 2017. In both cases, the taxpayers may opt to keep their records a year or two longer if their states have a statute of limitations longer than 3 years.

Important note: Even if you discard backup records, never throw away your file copy of any tax return (including W-2s). Often the return itself provides data that can be used in future tax return calculations or to prove amounts related to property transactions, social security benefits, etc. You should keep certain records for longer than 3 years. These records include:

- **Stock acquisition data.** If you own stock in a corporation, keep the purchase records for at least 4 years after the year you sell the stock. This data will be needed in order to prove the amount of profit (or loss) you had on the sale.
- **Stock and mutual fund statements where you reinvest dividends.** Many taxpayers use the dividends they receive from a stock or mutual fund to buy more shares of the same stock or fund. The reinvested amounts add to basis in the property and reduce gain when it is finally sold. Keep statements at least 4 years after final sale.
- **Tangible property purchase and improvement records.** Keep records of home, investment, rental property, or business property acquisitions AND related capital improvements for at least 4 years after the underlying property is sold.

If you have questions about what records to retain and what you can dispose of now, please give this office a call.

Naming Your IRA Beneficiary – More Complicated Than You Might Expect

Article Highlights:

- How naming beneficiaries impacts Traditional IRA distributions
- The impact of naming your trust as a beneficiary
- IRA beneficiary taxation

The decision concerning whom you wish to designate as the beneficiary of your traditional IRA is critically important. This decision affects:

- The minimum amounts you must withdraw from the IRA when you reach age 70 ½;
- Who will get what remains in the account after your death; and
- How that IRA balance can be paid out to beneficiaries.

What's more, a periodic review of whom you've named as IRA beneficiaries is vital to ensure that your overall estate planning objectives will be achieved in light of changes in the performance of your IRAs and in your personal, financial, and family situation.

The issue of naming a trust as the beneficiary of an IRA comes up regularly. There is no tax advantage to naming a trust as the beneficiary of an IRA. Of course, there may be a non-tax related reason, such as controlling a beneficiary's access to money; thus, naming a trust rather than an individual(s) as the beneficiary of an IRA could achieve that goal. However, that is not typically the case. Naming a trust as the beneficiary of an IRA eliminates the ability for multiple beneficiaries to maximize the opportunity to stretch the required minimum distributions (RMDs) over their individual life expectancies.

Generally, trusts are drafted so that IRA RMDs will pass through the trust directly to the individual trust beneficiary and, therefore, be taxed at the beneficiary's income tax rate. However, if the trust does not permit distribution to the beneficiary, then the RMDs will be taxed at the trust level, which has a tax rate of 39.6% on any taxable income in excess of $12,150 (2014 rate).

Distributions from traditional IRAs are always taxable whether they are paid to you or, upon your death, paid to your beneficiaries. Once you reach age 70 ½, you are required to begin taking distributions from your IRA. If your spouse is your beneficiary, he or she can delay distributions until he or she reaches age 70 ½ if he or she is under the age of 70 ½ upon inheritance of your IRA. The rules are tougher for non-spousal beneficiaries, who generally must begin taking distributions based upon a complicated set of rules.

Since IRA distributions are taxable to beneficiaries, beneficiaries usually wish to spread the taxation over a number of years. However, the tax code limits the number of years based on whether the decedent had, or had not, begun his or her age 70 ½ RMDs at the time of his or her death.

To ensure that your IRA will pass to your chosen beneficiary or beneficiaries, be certain that the beneficiary form on file with the custodian of your IRA reflects your current wishes. These forms allow you to designate both primary and alternate individual beneficiaries. If there is no beneficiary form on file, the custodian's default policy will dictate whether the IRA will go first to a living person or to your estate.

This is a simplified overview of the issues related to naming a beneficiary and the impact on post-death distributions. Uncle Sam wants the tax paid on the distributions, and the rules pertaining to how and when beneficiaries must take taxable distributions are very complicated. It may be appropriate to consult with this office regarding your particular circumstances before naming beneficiaries.

Tax Benefits for Grandchildren

Article Highlights:

- Financially assisting grandchildren
- College savings
- Education savings
- Retirement accounts
- Medical expenses

If you are a grandparent there are a number of things you can do to teach your grandchildren financial responsibility and set aside money for their future education and retirement. Before we get into actual suggestions, it is important that you understand the gift tax rules. You can give anyone, every year, an amount up to the annual gift tax exclusion. The gift tax exclusion is inflation-adjusted and is currently $14,000, which means that, in 2014, you can give any number of recipients up to $14,000. Thus, you can give each grandchild $14,000 per year; and, if you are married, both you and your spouse can each give $14,000 for a total of $28,000 per year. Gifts in excess of $14,000 per donee can certainly be made, but doing so will mean the grandparent must file a Gift Tax Return (Form 709) and pay gift tax on taxable gifts in excess of a lifetime gift and estate tax exclusion ($5.34 million for 2014).

Of course, just handing out money to your grandchildren will not teach financial responsibility or meet specific goals you might have in mind for the money. The following are some suggestions.

Savings for College: The tax code allows taxpayers to put away large amounts of money limited only by the contributor's gift tax concerns and the contribution limits of the intended state plan. There are no income or age limitations for these plans, often referred to as Sec. 529 Plans (the tax code number) or Qualified Tuition Plans. The maximum amount – per beneficiary – that can be contributed is based on the projected cost of a college education and will vary among state plans. Some states base their maximum on an in-state four-year education, while others use the cost of the most expensive schools in the U.S., including graduate studies. These plans allow for tax-free accumulation provided the funds are used for qualified college expenses. Thus, a grandparent can currently contribute up to $14,000 per year to a Sec. 529 Plan. There are also special provisions that permit 5 years' worth of contributions up front (this requires filing gift tax returns).

Savings for Education: Funds from a Sec. 529 plan can only be used for college. Coverdell Education Accounts also provide tax-free accumulation like Sec. 529 plans; but, unlike Sec. 529 Plans, the funds can be used for education beginning with kindergarten and continuing through college. So, you might want to consider contributing the first $2,000 (Coverdell annual contribution limit) to a Coverdell account. One downside to a Coverdell account is that it becomes the child's account to do with as the child wishes when the child reaches the age of majority (age varies by state); while, with the Sec. 529 plan, the contributor maintains control of the plan's distributions.

Roth Retirement Account: You may have a teenage grandchild who has a part-time job. To the extent the child has earnings from work, you – the grandparent – could fund an IRA for him or her. Generally, a child with a part time job will benefit very little, if any, from a traditional IRA deduction, so a Roth IRA is generally a better choice. Any contribution for 2014 would be limited to the lesser of $5,500 or the child's earned income. A Roth IRA accumulates earnings tax-free and distributions are tax-free at retirement age. The amount of the IRA contribution you pay is considered a gift to the grandchild, and it goes against the annual gift tax exclusion amount. For example, if your grandchild had $3,500 of wage income in 2014 and you funded $3,500 into an IRA for the grandchild, the remaining balance of the $14,000 annual exclusion would be $10,500. If you decided to buy your grandchild a $12,000 used car later the same year, you would be over the annual exclusion amount by $1,500 and would need to file a gift tax return. You would likely not owe any gift tax unless you've previously made large gifts, but the $1,500 does reduce your lifetime gift and estate tax exclusion.

Tuition and Medical Gift Exclusion – In addition to the annual exclusion, a grandparent may make gifts that are totally excluded from the gift tax in the following circumstances:

- Payments made **directly** (Sec. 529 plans are not direct) to an educational institution for tuition. This includes college and private primary education. It does not include books or room and board. This could also create a tax credit of up to $2,500 for the individual who claims your grandchild as a dependent.
- Payments made directly to any person or entity providing medical care for the donee.

In both cases, it is critical that the payments be made directly to the educational institution or health care provider. Reimbursement paid to the donee will not qualify. The tuition/medical exclusion is often overlooked, but these expenses can be quite significant. Grandparents interested in reducing the value of their estate should strongly consider these gifts.

Establish Trusts – Although a somewhat more complicated possibility and one that will require the services of a trust attorney, there are a variety of trusts that can be established to make future distributions to a grandchild based upon the grandchild's future achievements, such as completing his or her college education, holding a job, overcoming an addiction, etc.

Although none of these suggestions provides any current tax benefits for grandparents other than reducing the value of their future estate, they will help grandchildren get off to a good start in life. Please call this office for further details.

Tax Breaks for Charity Volunteers

Article Highlights:

- Away-from-home travel
- Lodging and meals
- Entertaining for charity
- Automobile travel
- Uniforms
- Substantiation requirements

If you volunteer your time for a charity, you may qualify for some tax breaks. Although no tax deduction is allowed for the value of services performed for a charity, there are deductions permitted for out-of-pocket costs incurred while performing the services. The normal deduction limits and substantiation rules also apply. The following are some examples:

- Away-from-home travel expenses while performing services for a charity, including out-of-pocket round-trip travel cost, taxi fares, and other costs of transportation between the airport or station and hotel, plus lodging and meals at 100%. These expenses are only deductible if there is no significant element of personal pleasure associated with the travel, or if your services for a charity do not involve lobbying activities.

- The cost of entertaining others on behalf of a charity, such as wining and dining a potential large contributor (but the cost of your own entertainment or meal is not deductible).
- If you use your car while performing services for a charitable organization, you may deduct your actual unreimbursed expenses directly attributable to the services, such as gas and oil costs, or you may deduct a flat 14 cents per mile for the charitable use of your car. You may also deduct parking fees and tolls.
- You can deduct the cost of the uniform you wear when doing volunteer work for the charity, as long as the uniform has no general utility. The cost of cleaning the uniform can also be deducted.

There are some misconceptions as to what constitutes a charitable deduction and the following are frequently encountered issues:

- No deduction is allowed for the depreciation of a capital asset as a charitable deduction. This includes vehicles, computers, etc.

  Example: *Kathy volunteers as a member of the sheriff's mounted search and rescue team. As part of volunteering, Kathy is required to provide a horse. Kathy is not allowed to deduct the cost of purchasing or to depreciate her horse. She can, however, deduct uniforms, travel, and other out-of-pocket expenses associated with the volunteer work.*

  However, a taxpayer may deduct the cost of maintaining a personally owned asset to the extent its use relates to providing services for a charity. Thus, for example, a taxpayer was allowed to deduct the fuel, maintenance and repair costs (but not depreciation or the fair rental value) of piloting his plane in connection with volunteer activities for the Civil Air Patrol. Similarly, a taxpayer, such as Kathy in our example, who participated in a mounted posse that was a civilian reserve unit of the county sheriff's office, could deduct the cost of maintaining a horse (shoeing and stabling).

- A taxpayer who buys an asset and uses it while performing volunteer services for a charity can't deduct its cost if he retains ownership of it. That's true even if the asset is used exclusively for charitable purposes.

No charitable deduction is allowed for a contribution of $250 or more unless you substantiate the contribution with a written acknowledgment from the charitable organization. To verify your contribution:

- Get written documentation from the charity about the nature of your volunteering activity and the need for related expenses to be paid. For example, if you travel out of town as a volunteer, request a letter from the charity explaining why you're needed at the out-of-town location.
- You should submit a statement of expenses if you are paying out of pocket for substantial amounts and, preferably, a copy of the receipts to the charity, then arrange for the charity to acknowledge the amount of the contribution in writing.
- Maintain detailed records of your out-of-pocket expenses—receipts plus a written record of the time, place, amount, and charitable purpose of the expense.

For additional details related to expenses incurred as a charity volunteer, please contact this office.

Depositing Payments in QuickBooks: The Basics

Creating bank deposits manually can be a huge chore. QuickBooks simplifies this task.

Satisfying though it may be to enter all of those customer payments manually on a paper deposit slip, it can also be tedious and time-consuming. The more successful in business you are, the more time and care it takes.

Whether you accept cash, checks, or credit/debit cards, QuickBooks has tools that help you streamline the process of moving the funds into your physical bank accounts. In fact, part of your job is done when you enter the payments on the **Receive Payments** or Sales Receipt screens.

An Important Decision
When you record a payment in QuickBooks, you can enter it in one of two ways. Ask us if

you're not certain which one best suits your business. Payments can be deposited:

- **In a specific bank account.** QuickBooks lets you specify an individual account for each transaction. If you select this option, a box labeled **DEPOSIT TO** will appear on the **Sales Receipt** and **Receive Payment** screens. Select an account from the drop-down list, and your payment will be automatically deposited into it.

Figure 1: You can choose to deposit customer payments to specific accounts.

- **In Undeposited Funds.** This is an asset account that can hold multiple payments, but they are not automatically deposited.

If you decide to have all payments sent to the **Undeposited Funds** account, you can establish that as your default. Open the **Edit** menu and select **Preferences | Payments | Company Preferences**. Then make sure that the box in front of **Use Undeposited Funds as a default deposit to account** is checked.

Figure 2: Check the box on the right if you want payments sent to the Undeposited Funds asset account. You will make the actual deposits later. If this box is not checked, a DEPOSIT TO field will appear on the Sales Receipt and Receive Payments screens.

Other Deposits

What about money you receive that is neither payment on an invoice you sent or payment for an item or service received immediately? There are many situations where this might be the case, including:

- Vendor refunds, rebates, etc.,
- Unsolicited donations [for non-profits], or

- An owner's investment in the business.

To record incoming funds like these, open the **Banking** menu and select **Make Deposits** to open the **Payments to Deposit** window. Click **OK** to skip to the **Make Deposits** window.

Complete the **Deposit To**, **Date**, and **Memo** fields, then click in the table below them if you haven't already used the **Tab** key to get there. Use the drop-down lists to select (or add) the individual or company who submitted the payment, the account where it should be tracked, the payment method, and the amount. Enter any additional information needed, fill in the optional ***Cash back goes to*** fields, and then save the transaction.

*Note: While you're working in the **Make Deposits** window, you can click the **Payments** button at any time to open a new window containing customer payments that need to be deposited if you want to process them simultaneously.*

*You may also want to use the **Attach** tool for miscellaneous payments to store related documentation.*

Depositing Undeposited Funds
You should process your **Undeposited Funds** on a regular basis, whether every day, every few days, or weekly, depending on your banking needs. To do this, go to **Banking | Make Deposits**.

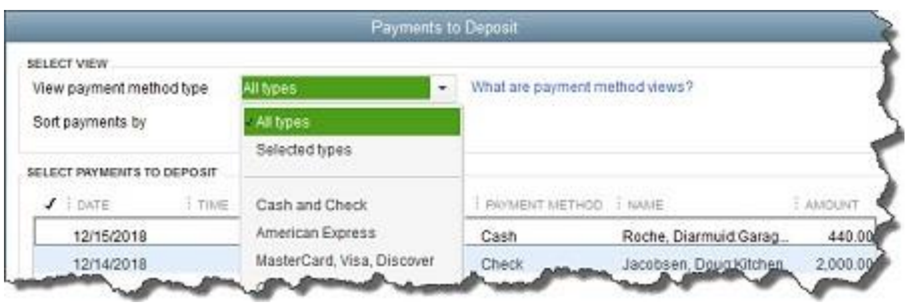

Figure 3: You can either view all of the unprocessed payments in Undeposited Funds in a single list, or you can display them by type.

The **Payments to Deposit** window will open *if you have pending payments in your **Undeposited Funds*** account. Put a check mark in front of all of the payments you want to deposit by clicking in the column to the left of the **DATE** column.

Click **OK**, and the **Make Deposits** window will open, displaying the payments you just chose. As we instructed previously, select the account where you want the money deposited and the date, add a memo, and request cash back if desired. Save your work when you're finished.

These are the steps you'll take to deposit payments by cash and check. If you're planning to open a merchant account so you can accept debit and credit cards, the process is similar, but there are additional steps you must take to ensure that your books balance.

We can show you the ropes and answer any other questions you have about depositing payments. You work hard for your money, so make sure you see it in your bank accounts.