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No Health Insurance? Qualify for Hardship Waiver?

Article Summary

- Uninsured penalty exemptions
- Applications for penalty exemptions
- Figuring the penalty
- Marketplace open enrollment starts November 15

If you didn't get health insurance coverage this year, you may be subject to a penalty unless you qualify for one of the many general or hardship exemptions. There are in excess of 30 possible exemptions from the penalty and some of the exemptions require you to complete and file an application for approval. If approved for an exemption that requires specific approval, you will be issued an exemption certificate number (ECN) that must be included on your tax return to claim the exemption.

The approval form instructions cover several types of exemptions, will take some time to complete; and, once the application is submitted, the approval/denial process presently takes more than two weeks. Once others realize they need approval for certain hardship exemptions, however, you can expect the approval process to take considerably longer. While application forms are available online, each application must be printed, filled out manually, and then snail-mailed to the government for processing. With tax season just around the corner, you don't want your refund held up while you are applying for an exemption; so, start the process early.

Not all exemptions require approval, so make sure your reason for an exemption requires advance approval before going to the trouble of completing and submitting the form. If you qualify for an exemption that doesn't require prior approval, you can claim it on a new IRS form that will need to be included with your 2014 tax return.

If you didn't have insurance for some period of time during the year (the penalty is computed by the month) and you don't qualify for one or more of the exemptions, then you will be subject to the penalty for not being insured (the official name for the penalty is the "shared responsibility payment").

The penalty is generally the larger of a flat dollar amount per individual or a percentage of your income, whichever is greater. For 2014, the full-year penalty, based upon the flat dollar amount, is $95 per adult and $47.50 per child, capped at $285 regardless of family size. The full-year penalty determined by income is 1% of the amount that your household income exceeds your tax filing income threshold.

> ***Example:*** *For 2014, Kevin and Brett are married filing jointly with two minor children. Their household income is $55,000 and their filing threshold is $20,300 (their standard deduction of $12,400 plus the exemption amount of $3,950 each for both of them). So, their flat dollar amount for a full year would be $285, and their percentage of income amount would be $347.00*

(($55,000 - $20,300) x 1%). Thus their penalty would be $347.00 for a full year without insurance or $28.92 per month for the family.

For the first year of the shared responsibility payment, 2014, the penalties are low. In 2015, the flat dollar amounts jump to $325 per adult and $162.50 per child (capped at $975), while the percentage of income jumps to 2%. Then, in 2016, the per-adult flat dollar amount goes to $695 and the child amount to $347.50 (maximum $2,085), while the percentage of income increases to 2.5%. If our prior example had taken place in 2016, Kevin's and Brett's penalty would be $2,085 (2 x $695 plus 2 x $347.50) since the flat dollar amount is larger than their percentage of income amount.

Kevin and Brett, based upon their income, would qualify for some amount of premium assistance credit that will help them pay the cost of their health insurance if they purchase coverage through a government marketplace. With the severe increase in penalties over the next two years, Kevin and Brett will need to consider whether the cost of health insurance (and the benefits that come with coverage) is a better option than paying the penalty. Open enrollment for 2015 marketplace insurance begins November 15, 2014.

If you have questions about the shared responsibility payment or penalty exemptions you may qualify for, please give this office a call.

Refinanced Mortgage Interest May Not All Be Deductible

Article Highlights:

- Refinancing home mortgage interest
- Acquisition debt
- Equity debt
- Traceable debt
- Allocations
- Alternative minimum tax

Mortgage interest rates continue to be low, and home values are on the uptick. If you are considering a refinance, there are some important home mortgage interest rules you should be aware of.

Generally, the mortgage interest that you may deduct on your home includes the interest paid on the acquisition debt and on up to $100,000 of equity debt, provided the combined debt does not exceed the lesser of the value of the home or $1,100,000. Acquisition debt is the debt incurred to buy the home or substantially improve it, while equity debt is funds borrowed against the home for other uses.

A big problem arises when taxpayers fail to consider that acquisition debt steadily declines over the life of the loan. So, for example, if the original acquisition debt was $400,000 and you refinance 15 years later, the acquisition debt has probably been paid down to somewhere around $300,000. In this case, if the loan was refinanced for $475,000, the refinanced debt would be allocated $300,000 to acquisition debt, $100,000 to equity debt and $75,000 to debt for which the interest would not be deductible as home mortgage interest. In this case, the interest paid on the $300,000 acquisition debt and the $100,000 equity debt would be deductible as home mortgage interest. If the use of the $75,000 can be traced to another deductible use (e.g., purchase of taxable investments or expenses related to operating a business), then the interest on the $75,000 loan would be deductible per the limitations of the other deductible use. If the use of the $75,000 cannot be traced to an interest-deductible use, then the interest would not be deductible.

In the example above, the interest would be allocated as follows: 63.15% as acquisition debt interest, 21.05% as equity debt interest and 15.79% as interest not deductible as home mortgage interest. The result would be different if some or all of the new loan in excess of the $300,000 acquisition debt was used to make improvements to the home. For example, say that $125,000 of the new loan was used to add a bedroom and bathroom to the home. This increases the home acquisition debt to $425,000, leaving $50,000 as equity debt, and the interest would all be deductible because the equity debt amount would then be under $100,000.

If you have already refinanced or are thinking of doing so, it is imperative that you retain a record of the terms of the original acquisition debt in case you exceed the debt limitation and need to prorate your interest deduction.

When refinancing, you also need to watch out for the alternative minimum tax (AMT). The AMT is another way of computing tax liability that is used if it is greater than the regular method. Congress originally conceived the AMT as a means of extracting a minimum tax from high-income taxpayers who have significant items of tax shelter and/or tax-favored deductions. Since the AMT was created, inflation has driven up income and deductions so that more individuals are becoming subject to the AMT.

When computing the AMT, only the acquisition debt interest is allowed as a deduction; home equity debt interest is not. Neither is the interest on debt for unconventional homes such as boats and motor homes, even if they are the primary residence of the taxpayer.

Before you refinance a home mortgage, it may be appropriate to contact this office to determine the tax implication of your planned refinance and see if there are any other suitable alternatives.

Large Employers Must Offer Affordable Health Coverage Beginning In 2015

Article Highlights:

- Employers subject to the insurance mandate
- Full-time employees
- Seasonal employees
- Part-time employees
- Minimum essential coverage
- Employers with 50 but fewer than 100 full-time employees

In general, beginning January 1, 2015, employers with at least 100 full-time and full-time-equivalent employees must offer affordable health coverage that provides minimum value to at least 95% of their full-time employees and their dependents or they may be subject to an employer shared responsibility payment. This payment applies only if at least one of the employer's full-time employees qualifies for a premium tax credit through enrollment in a government Health Insurance Marketplace.

Generally, an employer is subject to the requirement to provide affordable health coverage in 2015 if the employer has 100 or more full-time employees. When determining the number of full-time employees, there are certain classes of employees that are excluded from the count—the most notable being certain seasonal employees. Although an employee is considered full-time if he or she works 30 or more hours per week, to determine if the employer has reached the 100 full-time employee threshold, part-time employee hours for a month are totaled and divided by 120, and the result is added to the full-time count. Thus, an employer with fewer than 100 full-time employees may be required to provide an insurance plan to the employer's full-time employees if the combination of full-time employees and the hours of part-time employees equal the equivalent of 100 full-time employees.

Each year, employers will determine, based on their current number of employees, whether they will be considered an applicable large employer for the next year. For example, if an employer has at least 100 full-time employees (including full-time equivalents) for 2014, it will be considered an applicable large employer for 2015. Employers average their number of employees across the months of the year to see whether they will be an applicable large employer for the next year. This averaging can take into account fluctuations that many employers may experience in their work force across the year.

Even though an employer determines whether it is subject to the mandate based upon the number of employees during the prior year, the penalty is based upon the current year's employees and is determined on a monthly basis.

Example: John has 90 full-time employees, plus he has 40 part-time employees. His part-time employees for the month of January worked 1,920 hours. That is the equivalent of 16 (1,920 / 120) full-time employees. Thus, the number of John's full-time employees for the month of January is 106 (90 + 16). As a result, John will have to provide his 90 full-time employees and their dependents with affordable health coverage for January or be subject to the shared responsibility payment (penalty) for that month, but only if at least one full-time employee receives a premium tax credit. The penalty is determined on a monthly basis.

Affordable health care coverage is minimum essential coverage where the employee's share of the cost is no more than 9.5% of the employee's household income.

Employers with 50 or more full-time employees are also subject to the shared responsibility payment (penalty), but not until 2016, and again only if one or more full-time employees claim a premium tax credit.

The foregoing is an abbreviated overview of the employer insurance mandate. The rules are complex. If you are unsure whether or not your business is subject to the penalty for 2015, please give this office a call. Don't delay: the penalties are substantial and in some cases may be higher than the cost of the insurance.

Tax Smart Gifting

Article Highlights:

- Lifetime exemption
- Annual exemption
- Medical exemption
- Education exemption
- Gifting techniques

Frequently, taxpayers think that gifts of cash, securities or other assets they give to other individuals are tax deductible and, in turn, the gift recipient sometimes thinks income tax must be paid on the gift received. Nothing is further from the truth. To fully understand the ramifications of gifting, one needs to realize that gift tax laws are interrelated with estate tax laws, and Uncle Sam does not want you giving away your wealth before you pass away to avoid inheritance taxes.

As a result, what you give away prior to death will reduce the amount that can pass to your beneficiaries free of inheritance taxes after your death. For 2015, the lifetime exemption from inheritance tax is $5.43 million. The following amounts do not reduce the lifetime exemption:

- **$14,000 each to any number of recipients during every tax year.** The amount is periodically adjusted for inflation, but the amount for 2015 remains at $14,000.
- **Directly pay medical expenses.** This applies to amounts paid by one individual on behalf of another individual <u>**directly**</u> to a provider of medical care as payment for that medical care. Payments for medical insurance qualify for this exclusion.
- **Directly pay education expenses.** This applies to amounts paid by one individual on behalf of another individual <u>**directly**</u> to a qualifying educational organization as tuition for that other individual. Costs of room and board aren't eligible as direct payments.

If the gift giver is married and both spouses are in agreement, gifts to recipients made during a year can be treated as split between the husband and wife, even if the cash or property gift was made by only one of them. Thus, by using this technique, a married couple can give $28,000 a year to each recipient under the annual limitation discussed previously.

Gifting Techniques:

High-Wealth Individuals – If you are a high-wealth individual who would like to pass as much on to your heirs as possible while living, without reducing the lifetime exemption, you could pay <u>directly</u> your heirs' medical expenses and higher education expenses in addition to annual gifts of cash or property of $14,000. You may want to do this, even if you are not a high-worth individual, to avoid having to file a gift tax return.

Medical Expenses – Except in rare circumstances, you cannot deduct the medical expenses you pay for another person, and they cannot deduct the expenses either since they did not pay them. Thus careful consideration should be given regarding whether you make the gift directly to the individual subject to the $14,000 annual limit, which would allow him or her to pay the medical expenses and claim the medical deduction on his or her tax return, or you pay the medical expenses directly. If the medical expenses you want to pay are greater than $14,000, then you could always gift $14,000 to the individual and pay the balance directly to the care provider(s), and thereby avoid reducing the lifetime exemption. Under rare circumstances, the recipient who will benefit from your gifts may qualify as your medical dependent, under which circumstance you would be able to deduct the medical expenses if they had been paid directly to the doctor, hospital or other provider.

Education Expenses – When you pay the qualified post-secondary education tuition for another individual, it does not mean, as is the case for medical expenses, that someone cannot benefit taxwise. Tax law says that whoever claims the exemption for the student is entitled to the American opportunity credit or lifetime learning credit for higher education expenses if they otherwise qualify.

Gifts of Appreciated Property – Consider replacing your cash gifts with gifts of appreciated property, such as stock for which you have a "paper gain." When you gift an appreciated asset, the potential gain on the asset transfers to the recipient. This works for individuals, except for children who are subject to the kiddie tax, which requires the child's income to be taxed at the parent's tax rate if it is higher than the child's rate. It also works great for contributions to charitable organizations. Although not subject to the gift tax rules, an appreciated asset gifted to a charity not only gets you out of reporting any gain from the appreciation, but you also get a charitable tax deduction equal to the fair market value (FMV) of the asset. The deduction for these gifts is generally limited to 30% of your adjusted gross income (AGI), but the excess carries over for up to five years of future returns.

Please call this office if you need assistance with planning your gifting strategies.

Getting the Most Out of Employee Business Expense Deductions

Article Highlights:

- 2% of income deduction floor
- Alternative minimum tax
- Employer accountable plan
- Bunch deductions
- Educational assistance plan
- Sec 179 Expensing

Individuals can deduct as miscellaneous itemized deductions certain expenses that they incur in the course of their employment. Generally, qualified business expenses are un-reimbursed expenses that are both ordinary (common and accepted in your industry) and necessary and do not include personal expenses.

There are two major barriers to deducting employee business expenses. The most commonly encountered is the 2%-of-income (AGI) deduction floor that applies to most (Tier II) miscellaneous deductions, which besides employee business expenses also includes investment expenses, certain legal expenses, home office and other expenses. The amount deductible as miscellaneous expenses is the total of those expenses reduced by 2% of the taxpayer's adjusted gross income for the year. Depending upon the taxpayer's income, this reduction can substantially lessen or eliminate the deductible amount. The second major barrier is the alternative minimum tax (AMT), in which the Tier II miscellaneous expenses are not deductible at all. Thus, to the extent that the taxpayer is affected by the AMT, there is no benefit derived from these deductions. There are, however, some planning strategies that can be applied to overcome these barriers, such as the following:

- **Employer Accountable Plan** – This is a plan under which your employer reimburses you for your employment-related expenses, but requires you to "adequately account" for the expenses. Expenses reimbursed by the employer under an "accountable plan" are excluded from income, thus essentially allowing 100% of the expenses to be deducted, while avoiding the 2%-of-income and AMT limitations. If the employer does not wish to add a reimbursement plan on top of the employee's existing income, a salary reduction replaced with an accountable plan might be negotiated.
- **Bunch Deductions** – With proper planning, employee business expenses for more than one year can be deferred or accelerated into one year, thus producing a larger deduction in that one year to overcome the 2% floor for miscellaneous deductions.
- **Education Expenses** – Although certain employment-related education expenses can be taken as an employee business expense, there are other ways to gain a tax benefit and avoid the 2%-of-AGI and AMT limitations. These include income-limited education tax credits, and if your employer has an educational assistance plan, your employer can reimburse you up to $5,250 for most education expenses other than those associated with education travel.
- **Utilize the Section 179 Deduction** – Generally, business assets with a useful life of more than one year must be deducted (depreciated) over several years. However, most business assets, other than real estate, qualify for the Code Section 179 expense deduction that allows the entire cost (up to $25,000 for 2015) to be deducted in one year. While vehicles used for business are eligible for Section 179 expensing, other limitations cap the deduction at lower amounts. The depreciation or Section 179 deduction of an employee's business assets is part of employee business expenses subject to the 2%-of-AGI floor. However, by claiming the Section 179 deduction in the year the asset is purchased rather than deducting a lower depreciation amount over several years, there is a greater chance that the total miscellaneous deductions will be more than the 2%-of-AGI floor, thus allowing part of the expense to be deducted.

If you would like to explore any of these techniques, please give this office a call.

Is a 1031 Exchange Right for You?
Article Highlights

- Basic rules of 1031 exchanges
- Advantages of exchanges
    - Tax deferral
    - Leveraging the tax savings
    - Asset accumulation
    - Potential management relief
- Disadvantages of exchanges
    - Added complexity and expense
    - Low tax basis
    - No property flipping
    - Unknown future law changes

If you own real property that you could sell for a substantial profit, you may have wondered whether there's a way to avoid or minimize the taxes that would result from such a sale. The answer is yes, if the property is business or investment related. Normally, the gain from a sale of a capital asset is taxable income, but Section 1031 of the Internal Revenue Code provides a way to postpone the tax on the gain if the property is exchanged for a like-kind property that is also used in business or held for investment. These transactions are often referred to as 1031 exchanges and may apply to other types of property besides real estate, but the information in this article is geared toward real property.

It is important to note that these exchanges are not "tax-free" but are "tax deferred." The gain that would otherwise be currently taxable will eventually be paid when the replacement property is sold in the future in a regular sale. As with all things tax, there are rules and regulations to be followed to ensure that the transaction qualifies, such as:

- The property must be given up and its replacement must be actively used in a trade or business or held for investment, so a personal residence or a vacation home won't qualify. However, under some circumstances a vacation home that has been rented out may qualify.

- The properties must be of like kind. For instance, this means you can't exchange real estate for an airplane. But the definition is quite broad for real property – for example, it is OK to exchange raw land for an office building, a single-family residential rental for an apartment building, or land in the city for farmland. Typically, the owner of a residential rental who participates in an exchange will trade for another residential rental. Both real estate properties must be located in the United States. Caution: Stocks, bonds, inventory, partnership interests and business goodwill are excluded from Sec 1031 exchanges.

- It is unusual for two taxpayers to each have a property that the other wants where they can enter into a simultaneous exchange. Most likely, if you wanted to exchange your property, you may need to do a "deferred exchange," which means you effectively sell your property and then find a suitable replacement property. In this case, the law is very strict. You must identify, in writing, the replacement property within 45 days of the date your property was transferred and complete the acquisition of the replacement property within 180 days of the transfer or, if earlier, by the due date, including extensions, of your tax return for the tax year in which your property was transferred. During this period you aren't allowed to receive the proceeds from the sale of your property.

- The property acquired in an exchange must be of equal or greater value to the one you gave up, and all of the net proceeds from the disposition of the relinquished property must be used to acquire the replacement property. Otherwise, any unused proceeds are taxable.

With this basic information about 1031 exchanges, you may still be wondering whether an exchange is right in your situation. So let's consider some of the advantages and disadvantages of exchanges.

ADVANTAGES:

Tax deferral – The main reason most people choose to do a 1031 exchange is so taxes don't have to be paid currently on the gain that would result from selling the property. The maximum federal tax rate paid on capital gains for most taxpayers is 15% (20% if you would otherwise be in the highest tax bracket of 39.6%). However, the part of the gain that is equal to the depreciation deduction you've claimed while you've owned the property is taxable at a maximum of 25%.

Leveraging the tax savings – When an exchange is used, the money that doesn't have to be spent to pay the taxes that would have been owed on the gain from a sale can be used to acquire other property or higher-value property.

Asset accumulation – The money saved from not paying tax on the sale gain can be retained as part of your estate to be passed to your heirs, who would also get a new basis on the replacement property that is equal to its fair market value at your date of death. In this case, none of the postponed gain from the original property is ever subject to income tax. However, depending on the overall size of your estate, there could be estate tax considerations.

Potential management relief – Taxpayers sometimes decide to sell their property to get out from under the burden of managing and maintaining the property. An exchange may still accomplish this without an outright sale by allowing the taxpayer to acquire replacement property that has fewer maintenance requirements and associated costs or has on-site management.

DISADVANTAGES:

Added complexity and expense – An exchange transaction involves more complexity than a straight sale. The timing requirements noted above must be strictly met or the transaction will be taxable. To avoid tainting the transaction when there's a deferred exchange, the proceeds from the original property must not be received by the seller, and a qualified intermediary, also called an accommodator, must be hired to handle the money and acquire the replacement property. The intermediary's fees will be in addition to the usual selling and purchase expenses incurred.

Low tax basis – The tax basis on the property acquired reflects the deferred gain, so the basis for depreciation will be low. Thus, the annual depreciation deduction will often be much less than it would be if the property were purchased outright. Upon sale of the property, the accumulated tax deferrals will catch up, and the result will then be a large tax bill.

No property flipping – The intent of the law permitting exchanges is for the taxpayer to continue to use the replacement property in his trade or business or as an investment. An immediate sale of the replacement property would not satisfy that requirement. How long must the replacement property be held? In most situations there is no specific guideline, but generally 2 years would probably suffice. "Intent" at the time of the exchange plays a major role according to the IRS.

Unknown future law changes – When weighing whether to do a 1031 exchange, consider the known tax liability if you sold your property versus the unknown tax that will be owed on the deferred gain when you eventually sell the replacement property in the future. If you think tax rates may be higher in the future, you may decide to pay the tax when you sell your original property and be done with it. Recent proposals by various members of Congress and President Obama would severely curtail or even eliminate 1031 exchanges and increase the depreciation period of real property from 27.5 years for residential property and 39 years for commercial property to 43 years for both. These proposals may never pass, but they are an indicator of how 1031 exchanges are currently viewed in Washington, D.C.

1031 exchanges are very complex transactions, and the information provided is very basic. Before you commit to an exchange, please call this office so that we can review your particular situation with you.

What to Do if You Receive a Dreaded IRS Letter

Article Highlights:

- CP2000 Series Notices
- Automated
- Frequently Issued In Error
- What You Should Do

When the IRS thinks it has found an issue with your tax return, it will contact you via mail with a CP series notice (most commonly CP2000). Please note that the IRS will never call or e-mail you initially about a tax delinquency. This is a trick used by scammers that has become quite prevalent.

Most commonly, these notices will include a proposed tax due and any interest or penalties. The notice will include an explanation of the examination process and how you can respond.

These automated notices are sent out year-round and are quite common. As the IRS tries to close the tax gap, it has become more aggressive in its collection efforts. In addition, with some taxpayers using low-quality tax mills or do-it-yourself software, there has been an increase in the number of notices sent over the years because of preparer error. A missed check box here, a misunderstanding of a credit there, overlooked income—it all adds up. One of the largest tax software providers for self-preparers even needed to hire a huge new workforce to help its users deal with the increase in notices caused by novice taxpayers trying to do their own tax returns.

This automated process starts when the IRS matches what you reported on your tax return to data reported by third parties. When this information does not agree, the automated collection effort begins.

But don’t panic - These notices often include errors. But you do need to realize that not responding by the 30-day deadline can have significant repercussions. The first thing to determine is which type of notice you have received. A CP2000 notice is quite different than many of the other CP notices that deal with identify theft, audit correspondence, earned income credit and much more. Also realize that a CP2000 notice includes a proposed, and almost always unfavorable, change to your tax return, and it is giving you an opportunity to dispute the proposed change. Procrastinating or ignoring the notice will only cause the IRS to ratchet up its collection efforts and make it increasingly difficult to dispute the proposed adjustment.

Sometimes the IRS will be correct. You may have overlooked a capital gain, income from a second job, etc. Quite frequently, the IRS is incorrect simply because its software isn’t sophisticated enough to pick up all the information on your attached schedules.

The first thing you should do is contact this office as quickly as possible so we can review the notice to determine whether it is correct and quickly respond to it.

Family, Income, and Residence Changes Can Affect Your Premium Tax Credit

Article Highlights:

- Advance premium tax credit (APTC)
- Repayment avoidance
- Things you should report
- Special enrollment period

If you get health insurance coverage through a government Health Insurance

Marketplace, it is very important that you keep the Marketplace aware of any changes in household income, marital status, and family size.

If you are receiving advance payments of the premium tax credit, it is particularly important that you report changes in circumstances, including moving, to the Marketplace. There's a simple reason: reporting these income and life changes lets the Marketplace update the information used to determine your eligibility for a Marketplace plan, which may affect the appropriate amount of advance payments of the premium tax credit that the government sends to your health insurer on your behalf.

Reporting the changes will help you avoid having too much or not enough premium assistance paid to reduce your monthly health insurance premiums. Getting too much premium assistance means you may owe additional money or get a smaller refund when you file your taxes. On the other hand, getting too little premium assistance could mean missing out on monthly premium assistance that you deserve.

Changes in circumstances that you should report to the Marketplace include, but are not limited to:

- An increase or decrease in your estimated household income
- Marriage or divorce
- The birth or adoption of a child
- Moving
- Starting a job that offers health insurance
- Gaining or losing your eligibility for other health care coverage

Many of these changes in circumstances—including moving out of the area served by your current Marketplace plan—qualify you for a special enrollment period to change or get insurance through the Marketplace. In most cases, if you qualify for the special enrollment period, you will have sixty days to enroll following the change in circumstances.

If you have questions about the premium tax credit or the advance payment of the credit, please give this office a call.

Watch Out for Charity Scams
Article Highlights:

- Fraudsters
- Urgent appeals
- Tips to avoid scams & ID theft
- Cash contribution tax documentation

Fall is a traditional time of year for gift giving, including charitable giving. But before you write those checks, you should also be aware that there are fraudsters out there who solicit on behalf of bogus charities or who aren't entirely honest about how a so-called charity will use your contribution.

Urgent appeals for aid that you get in person, by phone or mail, by e-mail, on websites, or on social networking sites may not be on the up-and-up. Fraudsters also pop up whenever there are natural disasters such as earthquakes, floods, etc., trying to coax you into making a donation that will go into their pockets, not to help victims of the disaster.

Unfortunately, legitimate charities face competition from fraudsters, so if you are thinking about giving to a charity with which you are not familiar, do your research to avoid swindlers who try to take advantage of your generosity. Here are tips to help make sure that your charitable contributions actually go to the cause you support.

- Donate to charities you know and trust. Be alert for charities that seem to have sprung up overnight in connection with current events.
- Ask if a caller is a paid fundraiser, who he/she works for, and what percentage of your donation goes to the charity and to the fundraiser. If you don't get a clear answer — or if you don't like the answer you get — consider donating to a different organization.
- Don't give out personal or financial information — including your credit card or bank account number — unless you know for sure that the charity is reputable.
- Never send cash: you can't be sure the organization will receive your donation, and you won't have a record for tax purposes.
- Never wire money to someone who claims to be a charity. Scammers often request donations to be wired because wiring money is like sending cash: once you send it, you can't get it back.
- If a donation request comes from a group claiming to help your local community (for example, local police or firefighters), ask the local agency if they have heard of the group and are getting financial support therefrom.
- Check out the charity with the Better Business Bureau's (BBB) Wise Giving Alliance, Charity Navigator, Charity Watch, or GuideStar.

Remember, in order to deduct a charitable contribution on your tax return, it must be a legitimate charity. Contributions to religious, charitable, scientific, educational, literary, and other institutions that are incorporated or recognized as organizations by the IRS may be deducted. Sometimes these organizations are referred to as 501(c)(3) organizations after the code section that allows them to be tax-exempt. Gifts to state and local government, the federal government, qualifying veterans and fraternal organizations, and certain nonprofit cemetery companies also may be deductible. Gifts to other kinds of nonprofits, such as business leagues, social clubs and homeowner's associations, as well as to individuals, cannot be deducted.

To claim a cash contribution, you must be able to document the contribution with a bank record that includes the name of the qualified organization, the date of the contribution, and the amount of the contribution or a receipt (or a letter or other written communication) from the qualified organization that shows the same information. Bank records may include a canceled check, a bank or credit union statement, or a credit card statement. In addition, to deduct a contribution of $250 or more, you must have an acknowledgment of your contribution from the qualified organization or certain payroll deduction records.

Ever Wonder What a Tax Deduction Might Save You?

Article Highlights:

- Non-business deductions
- AMT
- Tax bracket
- Above-the-line deductions
- Business deductions

Taxpayers frequently ask what benefit is derived from a tax deduction. Unfortunately, there is no straightforward answer. The reason the benefit cannot be determined simply is because some deductions are above-the-line, others must be itemized, some must exceed a threshold amount before being deductible, and certain ones are not deductible for alternative minimum tax purposes, while business deductions can offset both income and self-employment tax. In other words, there are many factors to consider, and the tax benefits differ for each individual, depending on his or her particular situation.

For most non-business deductions, the savings are based upon your tax bracket. For example, if you are in the 25% tax bracket, a $1,000 deduction would save you $250 in taxes. However, if taxable income is close to transitioning into the next-lower tax bracket, the benefit will be less. You also need to consider whether the particular deduction is allowed on your state return and what your state tax bracket is to determine the total tax savings.

Some deductions, such as IRA and self-employed retirement plan contributions, alimony, student loan interest, moving expenses, etc., are adjustments to income or what we call above-the-line deductions. These deductions, to the extent permitted by law, provide a dollar deduction for every dollar claimed. Deductions that fall into the itemized category must exceed the standard deduction for your filing status before any benefit is derived. In addition, the medical deductions are reduced by 10% (7.5% if age 65 or over) of your AGI (income), and the miscellaneous deductions are reduced by 2% of your AGI. High-income taxpayers are also subject to a phase-out of overall itemized deductions, and taxpayers subject to the alternative minimum tax will not be able to deduct miscellaneous deductions above the 2%-of-AGI floor, taxes, and home equity interest to the extent that the taxpayer is subject to the AMT.

The most beneficial deductions, business deductions, fall into two categories: employee business expenses, which are treated as miscellaneous itemized deductions subject to the limitations described previously, and self-employed business expenses that offset both income tax and, depending upon the circumstances, self-employment tax. For 2014, the self-employment tax rate is 12.4% of the first $117,000 of income subject to SE tax plus 2.9% for the Medicare tax with no cap. In addition, for high-income taxpayers, an additional 0.9%

Medicare tax may apply. For self-employed businesses with less than $117,000 of net income, the SE tax rate is 15.3%. Thus, for small businesses with profits of less than $117,000, the benefit derived from deductions generally will include the taxpayer's tax bracket plus 15.3%. For example, for a taxpayer in the 25% tax bracket, the benefit could be as much as 40.3% (25% + 15.3%) of the deduction. If the deduction were $2,000, the tax savings could be as much as $806 and more when the taxpayer's state income tax bracket is included.

If you are planning an expenditure and expect the tax deduction to help cover the cost, please give us a call in advance to ensure that the tax benefit is what you anticipate.

Some Tax Facts for Military Reservists

Article Highlights:

- Travel expenses
- Uniforms
- Early pension plan withdrawals

Members of the U.S. Armed Forces reserve component often have questions about the tax deductibility of expenses they incur as part of their service in a reserve unit.

A member of a reserve component of the Armed Forces is an individual who is in the:

- Army, Navy, Marine Corps, Air Force, or Coast Guard Reserve;
- Army National Guard of the United States;
- Air National Guard of the United States; or
- Reserve Corps of the Public Health Service.

Travel Expenses – Travel related to service as a reservist is limited. Generally anyone traveling to and from a work location within the general area in which they live is unable to deduct the travel expense. That would include the travel costs of reservists going between home and their local reserve unit.

However, Armed Forces reservists who travel more than 100 miles away from home and stay overnight in connection with service as a member of a reserve component can deduct travel expenses as an adjustment to gross income. Deductible expenses include unreimbursed expenses for transportation, meals (subject to a 50% limit) and lodging, but the deduction is limited to the amount the federal government pays its employees for travel expenses; i.e., the general federal government per diem rate for lodging, meals and incidental expenses applicable to the locale, as well as the standard mileage rate for car expenses plus parking and ferry fees and tolls.

This is in lieu of deducting those expenses as a miscellaneous itemized deduction (subject to a reduction equal to 2% of adjusted gross income). Thus, this deduction can be taken even if the taxpayer does not itemize his/her deductions.

Military Uniforms - Taxpayers generally cannot deduct the cost of uniforms if they are on full-time active duty in the Armed Forces. However, Armed Forces reservists can deduct the unreimbursed cost of uniforms if military regulations restrict them from wearing their uniforms except while on duty as a reservist. If the taxpayer is a student at an Armed Forces academy, they cannot deduct the cost of the uniforms if they replace regular clothing. However, the cost of insignia, shoulder boards, and related items are deductible. Civilian faculty and staff members of a military school can deduct the cost of uniforms.

Early Withdrawal Exception - Qualified reservists are permitted penalty-free withdrawal from IRAs, 401(k)s, and other retirement arrangements if ordered or called to active duty. A "qualified reservist distribution" is any distribution to an individual if distribution is made during the period beginning with the reservist's call to active duty through the close of the active duty period **and** provided the active duty period is in excess of 179 days or is for an indefinite period. Even though the penalty is waived, the distributions would still be taxable.

If you have questions related to these tax benefits, please give this office a call.

Business Owners Beware – New IRS Matching Program
Article Highlights:

- Form 1099-K
- IRS Matching 1099-K reported income to tax return reported income
- Letters from the IRS

Beginning in 2012, banks, credit card companies, and other third-party organizations that settle transactions were required to file informational returns with the IRS that reported a business's credit and debit card transactions and other electronic types of reportable income. The form used to file that information with the IRS is the 1099-K. If your business has credit/debit card transactions, then you, along with the IRS, have received this form in the past.

The information provided on the Form 1099-K allows the IRS to determine the business's gross income from credit and debit card sales and makes it easier to segregate credit/debit card sales from cash sales.

With Form 1099-K, the IRS is in the position to see if the credit card dollar figure reported on the tax return matches the bank's information return; the form will also allow them to see if a business's other sales from cash and check payments makes sense in the context of the firm's overall business.

As expected, the IRS has developed a program to match reported income on the income tax returns filed by businesses to the income reported on the 1099-Ks. The IRS' analysis includes comparing the percentage of income a specific business reported as coming from credit/debit cards and cash sales, for example, to what the typical percentage is for other businesses in the same industry. If you receive a letter from the IRS related to the 1099-K, then the IRS's computer thinks you underreported your business income and the agency is requesting an explanation for the discrepancy. Don't procrastinate or ignore the letter; it only makes matters worse.
If you receive one of these letters, it may be appropriate for you to seek professional assistance with preparing a response. Please give this office a call.

Employers: Beware of "Dumping" Employees on a Government Health Insurance Marketplace.

Article Overview:

- There are consequences to having employee health insurance reimbursement plans.
- Health insurance reimbursement plans do not qualify as employer group plans to satisfy the employer insurance mandate.
- Penalties can be as high $100 per day per employee for not having a qualified plan.

The IRS earlier this year cautioned employers of the consequences when an employer reimburses its employees for the cost of premiums the employees pay to purchase qualified health plans, either through a health insurance marketplace or outside the marketplace, rather than establishing a health insurance plan for its own employees.

Employers may think they can use this strategy to avoid the employer insurance mandate required by the Affordable Care Act that applies to mid- and large-size firms, as well as shift some of the expense of providing employee health care away from the employer. Not so, says the IRS, which refers to this method of avoiding the employer insurance mandate as a "dumping" strategy.

This type of arrangement, termed an "employer payment plan," is considered a group health plan by the IRS, and as such, is subject to the reform provisions of the Affordable Care Act (ACA) and the penalty that applies for failing to meet those provisions. These reforms include a prohibition on the annual limits for essential health benefits and a requirement to provide certain no-cost-sharing preventive care. Employer payment plans can't be integrated with individual policies to achieve the market reform requirements, and therefore they fail to satisfy the market reform requirements. As a result, the employer may be subject to a $100/day per employee excise tax penalty amounting to $36,500 per year per employee for failure to meet the ACA provisions.

However, an employer payment plan does not include an employer-sponsored arrangement under which an employee may choose either cash or an *after*-tax amount to be applied toward health coverage. Individual employers may establish payroll practices of forwarding post-tax employee wages to a health insurance issuer at the direction of an employee without establishing a group health plan.

The employer group insurance mandate takes effect in 2015 for larger employers (those with 100 or more full-time employees) and in 2016 for employers with 50 to 99 full-time employees that meet certain conditions. Employers with fewer than 50 full-time employees are not required to provide health insurance coverage for their employees.

One last item: because an employer payment plan is considered a group health plan, the employees participating in such an arrangement who purchase their health coverage through a marketplace cannot claim the premium assistance credit because employees who have an employer plan are not eligible for the credit.
If you have further questions related to this issue, please give this office a call.

How Employee Stock Options Are Taxed

Article Highlights:

- Non-statutory Option
- Wage Income
- Statutory (Incentive) Options
- Capital Gains
- Alternative Minimum Tax

Many companies, as an incentive to employees to help grow the companies' market value, will offer stock options to key employees. The options give the employee the right to buy up to a specified number of shares of the company's stock at a future date at a specific price. Generally, options are not immediately vested and must be held for a period of time before they can be exercised. Then, at some later date, and assuming the stock price has appreciated to a value higher than the option price, the employee can excise the options (buy the shares), paying the lower option price for the stock rather than the current market price. This gives the employee the opportunity to participate in the growth of the company through gains from the sale of the stock without the risk of ownership.

There are two basic types of employee stock options for tax purposes, a non-statutory option and a statutory option (also referred to as the incentive stock option), and their tax treatment is significantly different.

Non-statutory Option – The taxability of a non-statutory option occurs at the time the option is exercised. The gain is considered ordinary income (compensation) and is supposed to be included in the employee's W-2 for the year of exercise. We say "supposed to be" because it is not uncommon to see smaller firms mishandle the reporting.

The employee has the option to sell or hold the stock he or she has just purchased, but regardless of what he or she does with the stock, the gain, which is the difference between the option price and market price of the stock at the time of the exercise, is immediately taxable. Because of the immediate taxation, most employees who have been granted options will, when exercising their options, immediately sell their stock. Under that scenario, the W-2 will reflect the profit and Form 8949 (the tax form used to report sales of stock and other capital assets) may need to be prepared to show the sale, essentially with no gain or loss, so that the gross proceeds of sale reported on the return are matched up with the sale reported to IRS (on Form 1099-B). If there was a sales cost, such as a broker's commission, then the result would be a reportable loss, albeit usually a small amount. Since the difference between the option price and market price is included in wages, it is also subject to payroll taxes (FICA).

If an employee chooses to hold the stock, he or she would have to pay the tax on the difference between the option price and exercise price, plus the FICA tax, from other funds. If the stock subsequently declines in value, the employee is still stuck with the gain reported when the option was exercised. Any loss on the subsequent sale of the stock would be limited to the overall capital loss limitation of $3,000 per year.

Statutory (Incentive) Options – What makes the taxation of a statutory option different from a non-statutory option is that no amount of income is included in regular income when the option is exercised. Thus, the employee can continue to hold the stock without any tax liability; and, if he or she holds it long enough, any gain would become a long-term capital gain. To achieve long-term status, the stock must be held for:

- More than 1 year after the stock option was exercised, and
- More than 2 years after the option was granted.

The advantage of long-term capital gains is that they are taxed at lower maximum rates. For example, the capital gains tax rate is 15% for a taxpayer who is in the 25% tax bracket.

There is a dark side to statutory options, however. The difference between the option price and market price, termed the spread, is what is called a preference item for alternative minimum tax (AMT) purposes. If the spread is great enough, that might cause the AMT to kick in for the year of exercise. If a taxpayer is already subject to the AMT, this would add to the tax; and, even if not, it might push him or her into the AMT. The current year AMT will be in addition to any tax when the stock is ultimately sold but will establish a higher tax basis for the AMT should it come into play in the year the stock is eventually sold. Not all AMT scenarios can be addressed in this article in detail, so additional guidance may be appropriate.

If the stock is sold before it achieves the long-term holding period requirements described above, the tax treatment is essentially the same as for a non-statutory option.

If you are planning to exercise stock options and have questions, or wish to do some tax planning to minimize the tax bite, please give this office a call.

Creating Item Records in QuickBooks

Accurate, thorough item records inform your customers and help you track inventory levels correctly.

Whether you're selling one-of-a-kind items or stocking dozens of the same kinds of products, you need to create records for each. When it comes time to create invoices or sales receipts, your careful work defining each type of item will:

- Ensure that your customers receive correct descriptions and pricing,
- Provide the information you must know about your inventory levels, and,
- Help you make smart decisions about reordering.

You'll start this process by making sure that your QuickBooks file is set up to track inventory. Open the **Edit** menu and select **Preferences**, then **Items & Inventory**. Click the **Company Preferences** tab and click in the box in front of**Inventory and purchase orders** are activated if there isn't a check in the box already. Here, too, you can ask that QuickBooks warn you when there isn't enough inventory to sell. Click **OK** when you're finished.

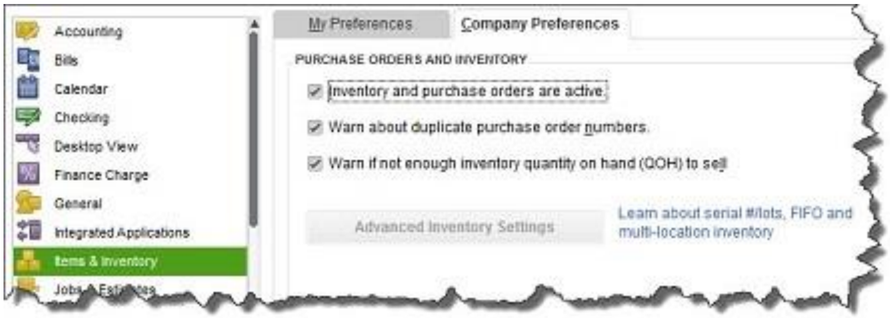

Figure 1: You need to be sure that QuickBooks knows you'll be tracking inventory before you start making sales.

To create your first item, open the **Lists** menu and select **Item List**. Click the down arrow next to **Item** in the lower left corner of the window that opens and select **New**. The **New Item** window opens.

Warning: You must be very precise when you're creating item records in order to avoid confusing your customers and creating problems with your accounting down the road. Please call us if you want us to walk you through the first few items.

QuickBooks should display the list of options below **TYPE**. Since you're going to be tracking inventory that you buy and sell, select **Inventory Part**. Enter a name and/or item number in the next field. This is not the text that will appear on transactions; it's simply for you to be able to recognize each item in your own bookkeeping.

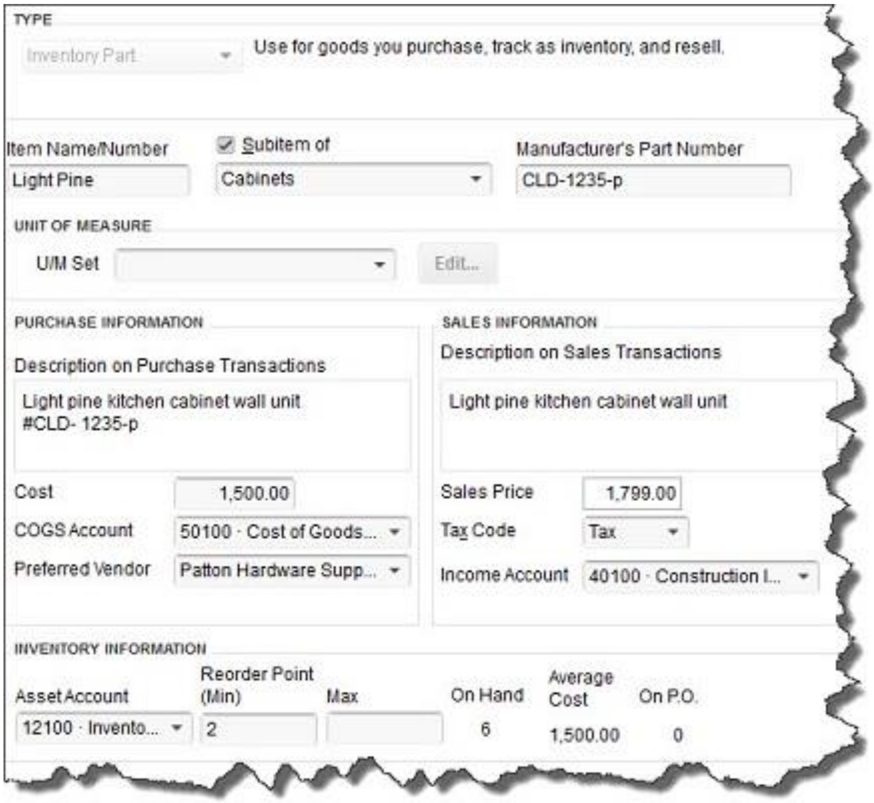

*Figure 2: Let us work with you if you have any doubts about the data that needs to be entered in the **New Item** window. It must be 100 percent accurate.*

In the example above, the box next to **Subitem of** has a check mark in it because "Light Pine" is only one of the cabinet types you sell (you can check this box and select <**Add New**> if you want to create a new "parent" item on the fly). Leave the next field blank if your item doesn't have a **Part Number**, and disregard **UNIT OF MEASURE** unless you're using QuickBooks Premier or above.

Fill in the **PURCHASE INFORMATION** and **SALES INFORMATION** fields (or select from the lists of options). Keep in mind that the descriptive text you enter here will appear on transaction forms, though customers will never see what you've actually paid for items, of course (your **Cost**, as opposed to the **Sales Price**).

QuickBooks should have automatically selected the **COGS Account** (Cost of Goods Sold), but you'll need to specify an**Income Account**. Please ask us if you're not sure, as this is a critical designation. The **Preferred Vendor** and **Tax Code**fields will display lists if you've already set these up.

QuickBooks should have pre-selected your **Asset Account**. If you want to be alerted when your inventory level for this item has fallen to a specific number (**Min**) so you can reorder up to the point you specify in the **Max** field, enter those numbers there (the **Inventory to Reorder** option must be turned on in **Edit |**

Preferences | Reminders).

If you already have this item in stock, enter the number under On Hand. QuickBooks will automatically calculate**Average Cost** and **On P.O.** (Purchase Order).

Click **OK** when you've completed all of the fields. This item will now appear in your **Item List**, and will be available to use in transactions. When you want to create, edit, delete, etc. any of your items, simply open the same menu you opened in the first step here (**Lists | Item List | Item**).

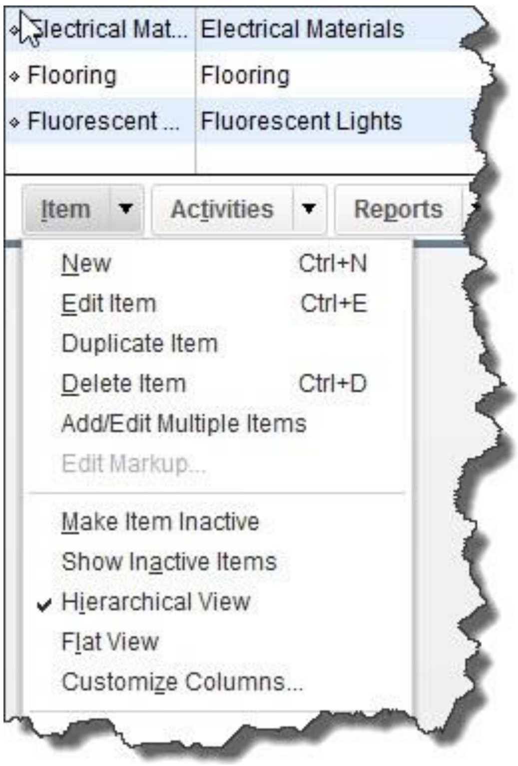

*Figure 3: The **Item** menu, found in the lower left corner of the **Item List**.*

Precisely created **Inventory Part** records are critical to accurate sales and purchase transactions. So use exceptional care in building them.