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Leslie A. Cesario, Ltd.
Monthly Newsletter

Don't Lose Your Insurance Subsidy in 2016 Because You Haven't Filed Your 2014 Return!

Article Highlights:

- Insurance Subsidy
- Advance Premium Tax Credit
- Non-filers
- 2016 Consequences of Not Filing

If you are one of the over 1 million individuals who received an Obamacare health insurance premium subsidy last year and have yet to file your 2014 tax return, you are risking your opportunity to receive a subsidy in 2016.

The subsidy, which is paid by the government to your insurer to reduce the premiums you owe, is actually an advance payment of the premium tax credit (PTC) based upon your "**estimated**" income for the year. Your actual PTC is based on your "**actual**" income as determined on your tax return. If the advance PTC (subsidy) was less than the actual PTC as determined on your tax return, you are entitled to the difference. On the other hand, if your actual PTC is less than the advance amount, you may owe Uncle Sam some or all of the difference.

Whether you are entitled to additional PTC or owe some back cannot be determined without filing your return. The IRS estimates that 710,000 individuals who received an advance PTC have yet to file a 2014 return or did not file an extension. Add that to the approximately 360,000 taxpayers who received an advance PTC and have filed an extension, and there are over 1 million individuals who need to reconcile their 2014 PTC who have not yet filed.

Because the Marketplace will determine eligibility for advance PTC for the 2016 coverage year during the fall of 2015, if you haven't filed your 2014 return yet, you can substantially increase your chances of avoiding a gap in receiving this help if you file your 2014 tax return as soon as possible, even if you have an extension until October 15th.

Navigating the complicated Obamacare forms developed by the IRS is difficult for many taxpayers, and most seek professional assistance. The IRS is currently sending letters to individuals who received advance PTC subsidies and have yet to file. The letter encourages taxpayers to file within 30 days of the date of the letter in order to avoid a gap in receiving advance payments of the PTC in 2016.

It is never a good idea not to file, even if you owe and can't pay. The IRS just gets more aggressive as time goes on. So whether you don't feel you can do your own return, are afraid you may owe some of the PTC back, or think you may be subject to penalties for failing to have health insurance coverage, we encourage you to give this office a call. There are penalty exceptions for being uninsured, or if you owe a PTC repayment there's a possibility it can be reduced, and it may all work out OK. Procrastinating isn't going to change the outcome and could put your 2016 advance PTC at risk. Who knows, you may even be entitled to more PTC and a refund.

Partnership, S-Corp and Trust Extensions End September 15

Article Highlights:

- September 15 is the extended due date for partnership, S-corporation, and trust tax returns.
- Late-filing penalty for partnerships and S-corporations
- Late-filing penalty for trust returns

If you have a calendar year 2014 partnership, S-corporation, or trust return on extension, don't forget the extension for filing those returns ends on September 15, 2015.

Pass-through entities such as Partnerships, S-corporations, and fiduciaries (trusts, estates) pass their income, deductions, credits, etc., through to their investors, partners, or beneficiaries, who in turn report the various items on their individual tax returns. Partnerships file Form 1065, S-corps file Form 1120-S, and Fiduciaries file Form 1041, with each partner, shareholder, or beneficiary receiving a Schedule K-1 from the entity that shows their share of the reportable items.

If all of the aforementioned entities could obtain an automatic extension to file their returns on the same extended date as allowed to individuals, it would be difficult for individuals to meet the filing deadline without estimating the pass-through information and then later filing an amended return when the actual data was received.

To overcome this problem, the automatic extension period for partnerships and trusts is set at 5 months, thus providing individual taxpayers with a month's grace period to complete their individual 1040 returns. The original due date for calendar year S-corporation returns was March 15, and they are allowed a 6-month extension period, making the due date for these returns also September 15. Thus, individual S-corp shareholders also have a month to finish up their individual returns.

An S-corporation or partnership which fails to file on time is liable for a monthly penalty equal to $195 times the number of persons who were partners, or shareholders for S corps, during any part of the taxable year, for each month or fraction of a month for which the failure continues. In addition, a $100 penalty may be imposed on the partnership or S-corp for each Schedule K-1 that it fails to timely provide to partners or S-corp members (maximum penalty per year is $1.5 million). These penalties can be substantial. Trusts are subject to a penalty of 5% of the tax due for each month, or part of a month, for which a return is not filed up to a maximum of 25% of the tax due. A $100 per beneficiary penalty may also apply for failure to timely provide a Schedule K-1. Each beneficiary, who receives a distribution of property or an allocation of an item of the estate, is required to be provided a Schedule K-1.

If this office is waiting for some missing information to complete your pass-through return, we will need that information at least a week before the September 15 due date. The late-filing penalties are substantial, so please call this office immediately if there are anticipated complications related to providing the needed information so a course of action can be determined to avoid the potential penalties.

Only One IRA Rollover Every 12 Months - Period!

Article Highlights:

- One rollover per 12-month period
- Tax consequences
- Difference between a rollover and a transfer
- Relief

Although this subject has been brought up before-and, yes, we are harping on the subject because of the profound tax consequences-this is a reminder that, beginning this year, individuals are only allowed one IRA rollover in any 12-month period (this includes SEP and Simple accounts, traditional and Roth IRAs). That is, 12 months must have elapsed from the date a rollover is <u>completed</u> before another rollover can be <u>made</u>. Failure to abide by this rule can be expensive. And the rule applies no matter how many IRAs an individual owns.

Example *– Joe makes an IRA rollover on March 1, 2015. He cannot roll over another IRA distribution, without penalties, until March 2, 2016.*

If Joe, in the example, were to make another IRA rollover before March 2, 2016, that entire distribution would be treated as a taxable distribution and would also be subject to the 10% early distribution penalty if Joe is under the age of 59.5 at the time of the distribution. Additionally, if Joe deposited the distributed amount into another IRA, or redeposited the funds into the same IRA, those funds are treated as an excess contribution and are subject to a 6% penalty per year for as long as they remain in the IRA.

That doesn't mean you can't transfer funds between IRA trustees multiple times during the year. In a rollover, a taxpayer takes possession of the funds and then must redeposit them within 60 days to avoid being taxed on the distribution. In contrast, a transfer moves the funds directly from one trustee to another with the taxpayer never taking possession of the funds. Unlimited direct transfers are allowed, including moving traditional IRA funds to a Roth IRA (called a conversion).

If, through no fault of yours, a trustee does not follow your instructions to make a transfer and instead distributes the funds to you, procedures are available to obtain relief.

If you are planning an IRA rollover, before taking the distribution, please check with your IRA trustee or call this office to ensure you are not violating the 12-month rule.

Reverse Mortgages - A Cash Flow Solution for Seniors

Article Highlights:

- Reverse Mortgages
- Reverse Mortgage Terms
- Who deducts the Interest?
- When is the Interest Deductible?

Some retirees are faced with mounting debt and inadequate income. What options do these seniors have, especially if they have a mortgage on their home and their retirement income is too low to cover the mortgage payments and have enough left over to have some enjoyment in their golden years?

One option that you see promoted on television is the “reverse mortgage” which allows a homeowner to borrow against the equity they have built up in their home over the years. The loan is not due until the homeowner passes away or moves out of the home. If the homeowner dies, the heirs can pay off the debt by selling the house and any remaining equity goes to them. If at that time the loan balance is equal to or more than the value of the home, the repayment amount is limited to the home’s worth.

In order to be eligible for this loan, the borrower must be at least 62 years of age and have equity in the home. The reverse mortgage must be a first trust deed. Thus any existing loans would have to be paid off with separate funds or with the proceeds from the reverse mortgage. The amount that can be borrowed is based upon age, and the older the borrower, the greater amount that can be borrowed and the lower the interest rate. The loan amount will also depend on the value of the home, interest rates and the amount of equity built up.

The borrower has the option of taking the loan as a lump sum, a line of credit, or as fixed monthly payments. In addition, the money generally can be used for any purpose, without restrictions imposed.

One question that always comes up when discussing reverse mortgages is, when will the interest be deductible? When determining whether reverse mortgage interest is deductible, when it is deductible and by whom, these are factors to consider:

1. Interest (regardless of type) is not deductible until paid. A reverse mortgage loan is not required to be repaid as long as the borrower lives in the home. Therefore, the interest on a reverse mortgage is not deductible by anyone until the loan is paid off.

2. Generally reverse mortgages are classified as equity loans and the deductible interest would be limited to the interest accrued on the first $100,000 of debt. There are exceptions where the reverse mortgage paid off an existing acquisition debt loan. Equity debt interest is not deductible by taxpayers subject to the alternative minimum tax (AMT).

So who deducts the interest when the loan is paid off?

Debtor - If the debtor pays off the loan while still living, the debtor is the one that deducts the sum of the interest they would have been entitled to deduct each year had it been paid, subject to the limitations discussed in 1 & 2 above.

Estate – If the estate pays off the mortgage after the debtor has passed away, the estate would deduct the interest it on its income tax return. The amount deductible would be the sum of the interest the debtor would have been entitled to deduct each year had they paid it, subject to the limitations discussed in 1 & 2 above.

Beneficiary – If the beneficiary, or beneficiaries, who inherit the home, pays off the mortgage, the interest would be deductible as an itemized deduction on their personal 1040 income tax return(s). The amount deductible would be the sum of the interest the debtor would have been entitled to deduct each year had they paid it, subject to the limitations discussed in 1 & 2 above.

Reverse mortgages have brought financial security to many seniors so that they can live a comfortable life. If you are a senior who is struggling with your finances, carefully explore your options, including the possibility of a reverse mortgage. Keep in mind, however, that some reverse mortgages may be more expensive than traditional home loans, and the upfront costs can be high, especially if you don't plan to be in your home for a long time or only need to borrow a small amount.

If you have questions about reverse mortgages and the mortgage interest deduction, please give this office a call.

Tax Tips for Disabled Taxpayers

Article Highlight:

- Increased Standard Deduction
- Tax Exempt Income
- Impairment-Related Work Expenses
- Earned Income Tax Credit
- Credit for the Elderly or Disabled
- Child or Dependent Care Credit
- Special Medical Deductions
- Qualified Medicaid Waiver Payments
- ABLE Accounts

Taxpayers with disabilities may qualify for a number of tax credits and benefits. Parents of children with disabilities may also qualify. Listed below are several tax credits and other benefits that are available if you or someone else listed on your federal tax return is disabled.

1. **Increased Standard Deduction** – If a tax return filer and/or spouse are legally blind, they are entitled to a higher standard deduction on their tax return.

2. **Exclusions from Gross Income** - Certain disability-related payments, Veterans Administration disability benefits, and Supplemental Security Income are excluded from gross income.

3. **Impairment-Related Work Expenses** - Employees, who have a physical or mental disability limiting their employment, may be able to claim business expenses in connection with their workplace. The expenses must be necessary for the taxpayer to work.

4. **Credit for the Elderly or Disabled** - This credit is generally available to certain taxpayers who are 65 and older, as well as to certain disabled taxpayers who are younger than 65 and are retired on permanent and total disability.

5. **Earned Income Tax Credit** - EITC is available to disabled taxpayers as well as to the parents of a child with a disability. If you retired on disability, taxable benefits that were received under your employer's disability retirement plan are considered earned income until a minimum retirement age is reached. The EITC is a tax credit that not only reduces a taxpayer's tax liability but may also result in a refund. Many working individuals with a disability who have no qualifying children, but are older than 25 and younger than 65, may qualify for EITC. Additionally, if the taxpayer's child is disabled, the age limitation for the EITC is waived. The EITC has no effect on certain public benefits. Any refund that is received because of the EITC will not be considered income when determining whether a taxpayer is eligible for benefit programs, such as Supplemental Security Income and Medicaid.

6. **Child or Dependent Care Credit** - Taxpayers who pay someone to come to their home and care for their dependent or disabled spouse may be entitled to claim this credit. For children this credit is usually limited to the care expenses paid only until age 13, but there is no age limit if the child is unable to care for him- or herself.

7. **Special Medical Deductions** – In addition to conventional medical deductions, the tax code provides special medical deductions related to disabled taxpayers and dependents. They include:

   • **Impairment-Related Expenses** - Amounts paid for special equipment installed in the home, or for improvements, may be included in medical expenses, if their main purpose is medical care for the taxpayer, the spouse, or a dependent. The cost of permanent improvements that increase the value of the property may only be partly included as a medical expense.

   • **Learning Disability** - Tuition fees paid to a special school for a child who has severe learning disabilities caused by mental or physical impairments, including nervous system disorders can be included in medical expenses. A doctor must recommend that the child attend the school. Tutoring fees recommended by a doctor for the child's tutoring by a teacher who is specially trained and qualified to work with children who have severe learning disabilities might also be included.

   • **Drug Addiction** - Amounts paid by a taxpayer to maintain a dependent in a therapeutic center for drug addicts, including the cost of the dependent's meals and lodging, are included in medical expenses.

8. **Exclusion Of Qualified Medicaid Waiver Payments** – Payments made to care providers caring for related individuals in the provider's home are excluded from the care provider's income. Qualified foster care payments are amounts paid under the foster care program of a state (or political subdivision of a state or a qualified foster care placement agency). For more information please call.

9. **ABLE Accounts** - Qualified ABLE programs provide the means for individuals and families to contribute and save for the purpose of supporting individuals with disabilities in maintaining their health, independence, and quality of life.

   Federal law enacted in 2014 authorizes the States to establish and operate an ABLE program. Under the ABLE program, an ABLE account may be set up for any eligible state resident, which would generally be the only person who could take distributions from the account. ABLE accounts are very similar in function to Sec 529 plans. However, they should not be considered as estate planning devices, as is sometimes the case with 529 plans; the main purpose of ABLE accounts is to shelter assets from means testing required by government benefit programs. Individuals can contribute to ABLE accounts subject to Gift Tax limitations. Distributions to the disabled individual are tax free if the funds are used for qualified expenses of the disabled individual. These accounts are new and must be established at the state level before taxpayers can start making contributions to them. Call the office for more information.

For more information on tax credits and benefits available to disabled taxpayers, please consult this office.

Keep Track of Your Investment Basis

Article Highlights:

- What is Basis?
- Cost Basis
- Gift Basis
- Inherited Basis
- Events That Adjust Basis
- First-in, First Out

In taxes, there is a saying: “Those who keep records win.” If you are an investor, you may have a variety of securities, including stocks, bonds, mutual funds, etc. When you sell those securities, naturally you want to minimize your gains or maximize your losses for tax purposes. Gain or loss is measured from your tax basis in the investment (asset), which makes it important to keep track of the basis in all your investments.

What is *Basis*? Generally, your basis in an investment begins with the price that was paid to purchase the investment. However, that will not be the case if the investment was acquired by gift or inheritance. For inherited assets, the basis generally begins with the FMV of the asset on the decedent’s date of death or an alternative valuation date, if chosen by the executor of the estate. Assets acquired by gift actually have a basis for gain - the donor’s basis - and a basis for loss - the fair market value of the asset on the date of the gift. When an asset is acquired through a division of property in a divorce, the asset retains the basis it had when it was owned jointly by the couple.

Basis is not a fixed value; it can change during the time the asset is owned and is adjusted by certain events. For an investment asset, these events include:

- Reinvested cash dividends,
- Stock splits and reverse splits,
- Stock dividends,
- Return of capital,
- Additional investments,
- Broker’s commissions,
- Interest previously taken into income under an election under the accrued market discount rules,
- Interest taken into income under the original issue discount rules,
- Attorney fees,
- Acquisition costs,
- Depletion,
- Casualty losses, etc.

These events can increase or decrease the tax basis in the investment, which makes adequate recordkeeping so important.

Another issue associated with basis is when a portion of the investment is sold. Let’s say 100 shares of a particular stock were purchased in 2011 at $10 a share and another 100 shares in 2013 at $20 a share. The investor plans on selling 100 shares of the stock at $30 a share. Using the general rule of “first in - first out,” there would be a $20 per share gain. However, if the investor can identify each specific block of stock sold, such as the 100 share block bought in 2013, there would only be a $10 per share profit. This is known as the “specific identification” method.

The following is a discussion of the more commonly encountered basis adjustments where recordkeeping is essential:

- **Reinvested cash dividends** – Investors are frequently given the opportunity to reinvest their dividends instead of taking them in cash. By participating in these plans, they are actually purchasing additional sales with their taxable dividends. Unless records are kept, the investor can’t prove how much he or she paid for the shares or establish the amount of gain that is subject to tax (or the amount of loss that can be deducted) when it is sold.

- **Stock dividends** – It is possible to receive both taxable and nontaxable stock dividends. Stock dividends that are taxable provide the investor with additional stock with a basis equal to the taxable stock dividend. If the dividends are nontaxable, the number of shares that are owned increases, but the basis remains unchanged. If the investor can associate the dividends with a specific block of stock, then the basis of that block can be adjusted accordingly. If not, the adjustment will apply to the entire holdings in that particular stock.

- **Return of capital** – A return of capital is a nontaxable return of a portion of the investment. Thus, a return of capital will reduce the investor’s basis in security. Suppose an investor has 100 shares of XYZ Corporation that cost $1,000 ($10 per share), and the corporation distributes to him a $100 nontaxable return capital. His basis in the stock is reduced to $900 ($1,000 - $100) or $9.00 per share. If, over a period of time, the return of capital exceeds his basis in the investment, then the excess becomes taxable because he cannot have a negative basis.

- **Stock splits** – Stock splits can be confusing if they are not tracked as they occur. Let's assume that an investor owns 100 shares of XYZ Corporation for which he paid $2,000 ($20 a share). Later on, the corporation splits the stock 2 for 1. The result is that he now owns 200 shares, but his basis in each has been reduced to $10 per share (200 shares times $10 equals $2,000 – what was paid for the original shares). This generally occurs when the "per share value of stocks" becomes too high for small investors to purchase 100 share blocks. Also watch for reverse splits, which have the opposite effect.

- **Stock spin-off** – Occasionally, corporations will spin-off additional companies. The most classic example is the break up of AT&T some years ago into regional phone companies, who themselves later split into additional companies or merged with others. Each time one of these transactions takes place, the corporation will provide documentation on how to split the prior basis between the resulting companies. Tracking these events as they happen is very important, as it may be difficult to reconstruct the information several years down the road.

- **Broker fees** – Although broker fees are a deductible expense, they are generally already accounted for in most stock and bond transactions. The purchase price of a block of stock generally includes the broker fees, and the sales price reported to the IRS (gross proceeds of sale) is the net of the sales costs.

Depending upon the investment vehicle, tracking the basis in an investment can be quite complicated. If you have questions, please contact this office.

Don't Forget Your Retirement!

Article Highlights:

- Simplified Employee Pension Plans (SEP)
- Qualified Plan (Keogh)
- Savings Incentive Match Plan for Employees (SIMPLE Plan)
- Individual 401(k) Plan
- Small Employer Pension Startup Credit

Even though retirement may be years away, and it may not be the most pressing issue on your mind these days, don't forget your retirement contributions, especially with generous government incentives involved.

There are a variety of retirement plans available to small businesses that allow the employer and employee a tax-favored way to save for retirement. Contributions made by the owner on his or her own behalf and for employees can be tax-deductible. Furthermore, the earnings on the contributions grow tax-free until the money is distributed from the plan. Here are some retirement plan options:

- **Simplified Employee Pension Plan (SEP).** This plan was designed to avoid the complications of a qualified plan. Contributions to the plan are held in the beneficiaries' IRA accounts; hence, the title "simplified." Deductible contributions for 2015 are limited to the lesser of 25% of the participant's compensation (up to $265,000) or $53,000. A SEP can be established and funded after the close of the year.

- **Qualified Plan (Keogh).** Generally, the rules surrounding a Keogh are more complex. This type of plan may include a discretionary contribution **profit sharing** plan or a mandatory contribution **money purchase plan**, or a combination of these. SEP plans are favored over Keogh plans by most self-employed individuals. For 2015, deductible contributions are limited to the lesser of 25% of the participant's compensation (up to $265,000) or $53,000. These plans must be established before the end of the tax year, but contributions can be made afterwards.

- **Savings Incentive Match Plan for Employees (SIMPLE Plan).** Under this plan, the business owner takes a deduction, and employees receive a salary deferral. For 2015, the contribution limit is $12,500 (per employer or employee), with an additional catch-up contribution limit of $3,000 for participants aged 50 or older. The employer can match the contribution up to 3% of compensation or make a non-elective contribution of 2% of compensation.

- **Individual 401(k) Plan.** The individual 401(k) plan is similar to the traditional 401(k) plan with added benefits for the small business owner. For 2015, the owner can contribute and deduct up to 25% of compensation plus an additional $18,000 salary deferral, up to a $53,000 maximum $59,000 for those who are age 50 and over). For employees, the contribution and salary deferral limit is $18,000, with an additional $6,000 catch-up contribution available to those aged 50 or over. Employers can match employee contributions.

If you do establish a new qualified pension plan for your business, you may be entitled to the "small employer pension startup credit." The credit is equal to 50% of administrative and retirement-related education expenses for the plan for each of the first three plan years, with a maximum credit of $500 for each year. Plan-related expenses in excess of the amount of the credit claimed are generally deductible as ordinary expenses of the business.

The first credit year is the tax year that includes the date the plan becomes effective, or, electively, the preceding tax year. Examples of qualifying expenses include the costs related to changing the employer's payroll system, consulting fees, and set-up fees for investment vehicles.

If you would like assistance in selecting a retirement plan for your business or to explore the tax benefits relevant to your particular circumstances, please give this office a call.

Back-to-School Tax Tips for Students and Parents

Article Highlights:

- Sec. 529 plans
- Coverdell Education Savings Accounts.
- The Lifetime Learning credit
- Qualified Education Loan Interest.

Going to college, and figuring out how to pay for it, can be stressful for students and parents. In recent years, Congress has provided a variety of tax incentives to help defray the cost of education. Some require long-term planning to become beneficial, while others provide current tax deductions or credits. The benefits may even cover vocational schools.

If your child is below college age, there are tax-advantaged plans that allow you to save for the cost of college. Although providing no tax benefit for contributions to the plans, they do provide tax-free accumulation; so the earlier they are established, the more you benefit from them.

- **Section 529 Plans**—Section 529 Plans (named after the section of the IRS Code that created them) are plans established to help families save and pay for college in a tax-advantaged way and are available to everyone, regardless of income. These state-sponsored plans allow you to gift large sums of money for a family member's college education while maintaining control of the funds. The earnings from these accounts grow tax-deferred and are tax-free, if used to pay for qualified higher education expenses. They can be used as an estate-planning tool as well, providing a means to transfer large amounts of money without gift tax. With all these tax benefits, 529 Plans are an excellent vehicle for college funding. Section 529 Plans come in two types, allowing you to either save funds in a tax-free account to be used later for higher education costs, or to prepay tuition for qualified universities. For 2015, you can contribute $14,000 without gift tax implications (or $28,000 for married couples who agree to split their gift). The annual amount is subject to inflation-adjustment. There is also a special gift provision allowing the donor to prepay five years of Sec 529 gifts up front without gift tax.

- **Coverdell Education Savings Account**—These accounts are actually education trusts that allow nondeductible contributions to be invested for a child's education. Tax on earnings from these accounts is deferred until the funds are withdrawn, and if used for qualified education purposes, the entire withdrawal can be tax-free. Qualified use of these funds includes elementary and secondary education expenses in addition to post-secondary schools (colleges). This is the only one of the educational tax benefits that allows tax-free use of the funds for below college-level expenses. A total of $2,000 per year can be contributed for each beneficiary under the age of 18. The ability to contribute to these plans phases out when the modified adjusted gross income is between $190,000 and $220,000 for married taxpayers filing jointly, and between $95,000 and $110,000 for all others.

- **Education Tax Credits—**Two tax credits, the American Opportunity Credit (partially refundable) and the Lifetime Learning Credit (nonrefundable), are available for qualified post-secondary education expenses for a taxpayer, spouse, and eligible dependents. Both credits will reduce one's tax liability dollar for dollar until the tax reaches zero. The credit is not allowed for taxpayers who file Married Separate returns.

    - *The American Opportunity Credit*—is a credit of up to $2,500 per student per year, covering the first four years of qualified post-secondary education. The credit is 100% of the first $2,000 of qualifying expenses plus 25% of the next $2,000 for a student attending college on at least a half-time basis. Forty percent of the American Opportunity credit is refundable (if the tax liability is reduced to zero). This credit phases out for joint filing taxpayers with modified adjusted gross income between $160,000 and $180,000, and between $80,000 and $90,000 for others.

    - *The Lifetime Learning Credit*—is a credit of up to 20% of the first $10,000 of qualifying higher education expenses. Unlike the American Opportunity Credit, which is on a per-student basis, this credit is per taxpayer. In addition to post-secondary education, the Lifetime Credit applies to any course of instruction at an eligible institution taken to acquire or improve job skills. For 2015 this credit phases out for joint filing taxpayers with modified adjusted gross income between $110,000 and $130,000, and between $55,000 and $65,000 for others. The credit is not allowed for taxpayers who file Married Separate returns.

  Qualifying expenses for these credits are generally limited to tuition. However, student activity fees and fees for course-related books, supplies, and equipment qualify if they must be paid directly to the educational institution for the enrollment or attendance of the student.

  You may qualify for this credit even if you did not pay the tuition. If a third party (someone other than the taxpayer or a claimed dependent) makes a payment directly to an eligible educational institution for a student's qualified tuition and related expenses, the student would be treated as having received the payment from the third party, and, in turn, pay the qualified tuition and related expenses. Furthermore, qualified tuition and related expenses paid by a student would be treated as paid by the taxpayer if the student is a claimed dependent of the taxpayer.

- **Education Loan Interest—**You can deduct qualified interest of $2,500 per year in computing AGI. This is not limited to government student loans and this could include home equity loans, credit card debt, etc., if the debt was incurred solely to pay for qualified higher education expenses. For 2015, this deduction phases out for married taxpayers with an AGI between $130,000 and $160,000 and for unmarried taxpayers between $65,000 and $80,000. This deduction is not allowed for taxpayers who file married separate returns.

We all know that a child's success in life has a great deal to do with the education they receive. You cannot start the planning process too early. Please call this office if you would like assistance in planning for your children's future education.

Avoiding IRS Underpayment Penalties

Article Highlights:

- Pay-as-you-go System
- Safe Harbor Payments
- Situations Triggering Underpayments
- True Safe Harbors

Congress considers our tax system as a "pay-as-you-go" system. To facilitate that concept, the government has provided several means of assisting taxpayers in meeting the "pay-as-you-go" requirement. These include:

- Payroll withholding for employers;
- Pension withholding for retirees; and
- Estimated tax payments for self-employed individuals and those with other sources of income not covered by withholding.

When a taxpayer fails to prepay a safe harbor (minimum) amount, he or she can be subject to the underpayment penalty. This nondeductible interest penalty is higher than what might be earned from a bank and is computed on a quarter-by-quarter basis.

Federal law and most states have safe harbor rules. There are two Federal safe harbor amounts that apply when the payments are made evenly throughout the year.

1. The first safe harbor is based on the tax owed in the current year. If your payments equal or exceed **90% of your current year's tax liability**, you can escape a penalty.
2. The second safe harbor – and the one taxpayers rely on most often – is based on your tax in the immediately preceding tax year. If your current year's payments equal or exceed **100% of the amount of your prior year's tax**, you can escape a penalty. If your prior year's adjusted gross income was more than $150,000 ($75,000 if you file married separate status), then your payments for the current year must be 110% of the prior year's tax to meet the safe harbor amount.

Where taxpayers get into trouble is when their income goes up or their withholding goes down for the current year versus the prior year. Examples are having a substantial increase in income, such as when investments are cashed in, thereby increasing income but without any corresponding withholding or estimated payments. Another frequently encountered situation is when a taxpayer retires and his payroll income is replaced with pension and Social Security income without adequate withholding. Taxpayers who don't recognize these types of situations often find themselves substantially underpaid and subject to the underpayment penalty when tax time comes around.

Bottom line, **100%** (or **110%** for upper-income taxpayers) **of your prior year's total tax** is the only true safe harbor because it is based on the prior year's tax (a known amount), whereas the 90% of the current year's tax amount is a variable based on the income for the current year, and often that amount isn't determined until it is too late to adjust the prepayment amounts.
Please contact this office promptly if you have a substantial increase in income, so that withholding or estimated tax payments can be adjusted to avoid a penalty

What Small Business Owners Need To Know About Balance Sheets

The most effective way for small business owners to be sure that they are aware of their company's financial status is to have an accurate balance sheet that reflects the most current information available. By keeping this information up to date every quarter, you can help yourself avoid a lot of problems and surprises down the road.

A balance sheet provides you with an at-a-glance summary of your company's financial health as of a specific day. It is broken down into what the business's assets are, what the business's liabilities are, and the amount of owner or shareholder equity. The balance sheet gets its name from the fact that the assets must be balanced by and equal to the liabilities plus the equity. Some business owners have found current balance sheets so helpful that they update them every month.

Understanding the Asset Portion of the Balance Sheet

When entering assets onto the balance sheet, the business owner needs to include everything that is owned by the business, whether current or liquid assets, **fixed assets**, or some other type of asset. Current or liquid assets include:

- Cash that is immediately available
- Money that is owed to you (Accounts Receivable)
- Products currently in stock (Inventory)
- Expenses paid in advance, such as insurance premiums

- Money-market accounts, investments and other securities
- Additional monies owed to you

Fixed assets are items that can't be easily sold or moved, including equipment and furnishings, buildings, land and vehicles. In most cases these assets depreciate, or decrease in value. Beyond current and fixed assets, items that are intangible, such as goodwill, copyrights and patents, are also considered assets on a balance sheet. It is important to note that money that is owed to you that you expect will not be paid is classified as a Reserve for Bad Debts, which decreases the amount of the Accounts Receivable on the balance sheet.

Understanding the Liability Portion of the Balance Sheet

When entering liabilities onto the balance sheet, the business owner needs to include all of the business's debts, both current and long term. Current liabilities include accounts payable, sales and payroll taxes, payments on short-term business loans such as a line of credit, and income taxes. Long-term liabilities are those that are paid over a longer period of time, generally over more than a year. These include mortgages and leases, future employee benefits, deferred taxes and long-term loans.

Understanding the Equity Portion of the Balance Sheet

When entering information onto the equity portion of the balance sheet, you should include the value of any capital stock that has been issued, any additional payments or capital from investors beyond the par value of the stock, and the net income that has been kept by the business rather than distributed to owners and shareholders.

In order to be sure that all of the information on the balance sheet is correct, you can double-check your numbers by subtracting assets from liabilities – the result should equal the equity amount. For more information on how to structure a balance sheet, check out this website: **sample balance sheet**.

The Value of a Balance Sheet

At first glance a balance sheet may look like an incomprehensible collection of numbers, but once you understand all of the various components and how they relate to one another, they will provide you with the opportunity to detect trends and spot issues before they become problems. Your balance sheet can alert you to:

- Times when inventory is outpacing revenue, thus alerting you to a need for better management of your inventory and production process
- Cash flow problems and a shortage of cash reserves
- Inadequacies in your cash reserves that are making it difficult to invest in continued growth
- Problems with collecting accounts receivables

The most essential tools that are available to you as a small business owner for gauging your operation's financial health are the balance sheet, the income statement and the cash flow statement. If you are uncomfortable with preparing these documents for yourself or don't have the time, then let a qualified professional take over and give yourself the information that you need.