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Was Your Refund Too High or Did You Owe Taxes? You Probably Need to Adjust Your W-4

Article Highlights:

- Large Refund or Tax Due
- Employers Withhold Based on W-4
- IRS Online Withholding Calculator
- Self-employed Taxpayers

If you are a wage earner and that is your primary source of income and you received a very large refund—or worse, if you owed money—then your employer is not withholding the correct amount of tax (but it probably isn't your employer's fault). Sure, you like a big refund, but you have to remember you are only getting your own money back that was over-withheld in the first place. Why not bank it and have access to it all year long instead of providing Uncle Sam with an interest-free loan?

Employers withhold tax based upon the information you provide them on Form W-4, and to adjust your withholding you will need to provide your employer with an updated W-4. Although the W-4 appears to be an easy form to fill out, this is where many taxpayers go wrong because they have other income, itemize their deductions or qualify for various tax credits.

You can solve this problem by using the IRS's online W-4 calculator that helps taxpayers determine the correct amount of allowances to claim on their W-4. It takes into account a variety of issues, including itemized deductions, other income, tax credits, and tax already withheld.

You will need the following available before using the IRS calculator:

- Your (and your spouse's if you file jointly) most recent pay stub
- A copy of your most recent income tax return

You will be required to estimate some values, so remember the results are only going to be as accurate as the input you provide.

Click Here To Access The IRS Withholding Calculator
http://apps.irs.gov/app/withholdingcalculator/index.jsp

Once you have determined the filing status and allowances to claim using the IRS calculator, download a copy of Form W-4, *Employee's Withholding Allowance Certificate*, fill it in and give it to your employer.

Caution: If you are uncomfortable using the IRS's online calculator, don't understand some of the terminology, or have multiple jobs or a working spouse, you may need professional help to determine the correct number of W-4 allowances. Also the federal W-4 allowances may not translate properly for your state withholding.

Tip: Once your employer has implemented the new W-4 allowance, double-check the withholding to make sure it is approximately what you had intended. It is not uncommon for errors to occur in an employer's payroll department that could lead to unpleasant surprises at tax time.

If you are self-employed, you generally pay estimated taxes instead of having payroll withholding. You may be self-employed and also have salaried employment, or your spouse may have payroll income or be self-employed. There are a multitude of possible combinations. If so, the IRS withholding calculator is not suitable for your needs, and you will probably need professional assistance in determining a combination of estimated taxes and payroll withholding.

Please call this office for assistance in preparing your W-4s and determining your estimated tax payments.

What Are the Tax Implications of Paying or Receiving Alimony?

Article Highlights:

- Definition of Alimony
- When Is It Income, and When Is It Deductible?
- IRA Qualification
- Effect of Child Support
- Need for Estimated Payments
- IRS Matching Program

Recently divorced individuals may pay or receive alimony. If this is your situation, here are some tips for how to correctly treat the payments on your tax return.

The first consideration is the definition of alimony. There are actually two definitions of alimony—one for payments made under divorce decrees and separation agreements established before 1985 and another for agreements established since that time. For the purposes of this article, only the rules for post-1984 decrees and agreements will be discussed.

For post-1984 decrees and agreements, alimony has the following requirements:

- The payments must be in cash paid to a spouse, ex-spouse or third party on behalf of a spouse or ex-spouse, and the payments must be made after the divorce decree is finalized. If made under a separation agreement, the payments must be made after the execution of that agreement.
- The payments must be required by a decree or instrument incident to divorce, a written separation agreement, or a support decree.
- The payments cannot be designated as child support. Child support payments are neither income for the recipient nor a deduction for the payer.
- Payments made while spouses or ex-spouses share the same household don't qualify as alimony. This is true even if the spouses live separately within a dwelling unit.
- The payments must end upon the death of the payee.
- The payments cannot be contingent on the status of a child. This is to prevent child support from being disguised as deductible alimony.

If payments you receive from or make to a spouse or former spouse meet the definition of alimony, those payments are taxable for the recipient and deductible for the payer. There is one exception to this rule, however: A divorce decree or separation agreement can designate that alimony payments are neither deductible nor taxable. If this is the case, the payments are not reportable on either party's tax return.

Here are some additional issues that should be considered.

- The IRS requires that a taxpayer deducting alimony include the payee's Social Security Number (SSN) on his or her tax return. Thus, the recipient must provide his or her SSN to the payer.
- The IRS has noted that a significant number of taxpayers incorrectly report their alimony by either understating the income or overstating the amount paid. As a result, the IRS computer compares the amounts listed on the payer's and recipient's tax returns, and it will initiate a correspondence audit where there is a discrepancy.
- The recipient of alimony payments may treat alimony payments as compensation even if those payments are that person's only income. This allows alimony recipients to save for their retirement by making either Traditional or Roth IRA contributions, the rules for which require the contributor to have earned income or compensation. Alimony income satisfies this requirement.
- If a divorce decree or other written instrument or agreement calls for both alimony and child support, and the person making the payments pays less than the total required, the payments apply first to child support. Any remaining amount is then considered alimony.
- There is no income tax withholding from alimony payments, so the recipient may need to consider making estimated tax payments.

Other complications can occur that are not addressed here. If you have such complications or wish to discuss alimony as it applies to your circumstances, please give this office a call.

Understanding the Fine Points of Capital Gains and Losses

Article Highlights:

- What is a Capital Asset?
- Long-Term Capital Gains Rates
- Capital Loss Limitations
- Asset Basis
- Net Investment Income Tax
- Home Sales
- Wash Sales

There is a category of income resulting from the sale of capital assets that receives special treatment for tax purposes.

A capital asset is defined to include property of any kind, whether held for business or personal use. Capital assets include all kinds of property, tangible and intangible; examples include land, buildings, plants and machinery, vehicles, furniture, jewelry, goodwill, tenancy rights, patents, trademarks, stocks and securities, mutual funds and homes.

Capital Gains - Generally, capital gains receive special tax rates if you have owned the capital asset for over a year, referred to as long-term capital gains. These special rates are 0%, 15% and 20% and are based on your regular tax bracket.

Thus:

- To the extent your regular tax bracket is less than 25%, the capital gains tax is zero.
- To the extent your regular tax bracket is 25% but less than 39.6%, the capital gains tax is 15%.

- To the extent your regular tax bracket is 39.6% or greater, the capital gains tax is 20%.

However, if the capital asset was held less than a year and a day, referred to as short-term capital gains, the gains are taxed at regular tax rates.

Capital Losses – For capital assets used personally, such as your car, home, jewelry, household items, etc., no losses are allowed. Business and investment losses are allowed and can offset gains but can only produce a maximum net loss for the year of $3,000 ($1,500 if filing as married separate). Any losses not allowed because of the annual net loss limit are carried forward to the next year.

Gains and Losses – These are determined by subtracting the capital asset's basis from the proceeds from sale, net of selling expenses. The basis of an asset is generally what you paid for it, but there are exceptions.

- *Gift* – If the asset was a gift, your basis will be the giver's basis at the time of the gift.
- *Inherited* – If you inherit an asset, your basis generally is the fair market value of the asset on the date of the decedent's death.
- *Business* – The basis of a business asset is its "adjusted basis," which is the cost adjusted for depreciation, improvements and casualty losses. In addition, there may be an element of ordinary income as a result of recaptured depreciation or reduction of basis due to cancellation of debt.
- *Investments* – Your original basis of shares of stock will need to be adjusted for events such as stock splits, spin-offs and dividend reinvestments.
- *Personal Use* – Even the basis of personal use property may be adjusted because of improvements, casualty losses and cancellation of debt.

Other Issues:

- *Net Investment Income* – The Affordable Care Act included an additional tax on net investment income for higher-income taxpayers. This 3.8% tax applies to net investment income of individuals with modified adjusted gross incomes in excess of:

  $200,000 for unmarried taxpayers,

  $250,000 for married taxpayers filing jointly,

  $125,000 for married taxpayers filing separately.

- *Home Sale Exclusion* – Where you have a gain from a primary residence you used and owned for 2 of the 5 years preceding the sale, married couples filing jointly can generally exclude $500,000 of the gain, and others can exclude $250,000. There are numerous special rules associated with home sales; call for additional information.
- *Wash Sales* – To prevent taxpayers from selling a stock or security to produce a tax loss and then immediately buying it back, the tax code includes wash sale rules that prevent the loss from being claimed if the stock is repurchased 30 days before or after the sale resulting in the loss.

There are numerous other issues not covered in this article that can come into play depending upon your particular circumstances. If you are anticipating the sale of an asset that will result in a substantial gain or loss, you are encouraged to contact this office prior to the transaction to ensure you get the maximum benefits of the tax laws.

Tax Benefits for Members of the Clergy

Article Highlights:

- Parsonage Allowance
- Primary Residence
- Fair Market Value Limitation
- Designation by Employing Organization
- Business Expenses and Excluded Income
- Retired Clergy
- Vow of Poverty
- Self-Employment Tax Exemption

Members of the clergy may qualify for two unique tax benefits: a tax-free parsonage allowance and exemption from self-employment tax on their ministerial earnings. Here are the details for both.

Parsonage/Rental Allowance Exclusion from Income – A "minister of the gospel" can qualify for the rental allowance exclusion from income if the home or rental allowance is provided as remuneration for services that are ordinarily the duties of a minister of the gospel. The following are qualifications and details for the exclusion allowance:

- The allowance is excludable only to the extent that it is used for expenses related to the minister's housing—e.g. rent, mortgage payments, utilities, repairs, etc.
- The rental allowance is not excludable to the extent that it exceeds reasonable compensation for the minister's services.
- The allowance only applies to the minister's primary residence.
- The allowance cannot exceed the fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities.
- The employing organization must designate the allowance by official action in advance of the payment. In addition, for a minister employed by a local congregation, the designation must come from the local church instead of the church's national organization.
- The portion of the minister's business expenses attributable to tax-free income is not deductible. This rule does not apply to home mortgage interest or taxes, which are deductible in full if the minister itemizes deductions.
- Retired clergy can exclude the rental value of a home or a rental allowance furnished as compensation for past services and authorized under a convention of their national church organization. However, the exclusion does not extend to the widow or widower of a retired clergyperson.

Minister's Exemption from Self-Employment Tax – A minister who hasn't taken a vow of poverty is subject to self-employment tax (SE tax) on income from services as a minister. (The church or other employing organization does not withhold Social Security or Medicare taxes from the minister's compensation.) Non-reimbursed business expenses are deductible in computing earnings subject to SE tax, even though the expenses are deductible only as itemized deductions for income tax computation purposes.

An ordained minister may be granted an exemption from SE tax for ministerial services only. To qualify, the church employing the minister must qualify as a religious organization under Code Section 501(c)(3).

Application for exemption is filed with Form 4361, Application for Exemption from Self-Employment Tax for Use by Ministers, Members of Religious Orders, and Christian Science Practitioners.

To claim the exemption from SE tax, the minister must meet all of the following conditions and file Form 4361 requesting exemption from SE tax. The minister must:

- Be conscientiously opposed to public insurance because of his or her individual religious considerations (not because of a general conscience), or be opposed because of the principles of his or her religious denomination.
- File for other than economic reasons.
- Inform the church's or order's ordaining, commissioning, or licensing body that he or she is opposed to public insurance if a minister or a member of a religious order (other than a vow-of-poverty member). This requirement doesn't apply to Christian Science practitioners or readers.
- Establish that the organization that ordained, commissioned, or licensed him or her, or his or her religious order, is a tax-exempt religious organization.
- Establish that the organization is a church or a convention or association of churches.
- Not have previously elected to be covered by Social Security by filing Form 2031, Revocation of Exemption from Self-Employment Tax for Use by Ministers, Members of Religious Orders, and Christian Science Practitioners.

The Form 4361 application must be filed on or before the extended due date of the return for the second tax year for which the individual has net earnings from self-employment of $400 or more (part of which is from services as a minister). A late application will be rejected.

The time for applying starts over when a minister who was not opposed to accepting public insurance (i.e., Social Security benefits) re-enters a new ministry (e.g., adopts a new set of beliefs that include opposition to public insurance with a different church). However, the IRS has said that there is no second chance to apply for exemption by a minister who is ordained in a different church but whose belief regarding public insurance doesn't change (i.e., the minister opposed acceptance of public insurance in both faiths).

Careful consideration should be made before applying for the exemption from SE tax since once the decision has been made, the election is irrevocable.

If you have questions related to either of these issues, please give this office a call.

Are You Caring for a Disabled Family Member? Read This.

Article Highlights:

- Caring for Disabled Family Members
- Qualified Medicaid Waiver Payments
- 2014 IRS Announcement
- Exclusion Qualifications
- Mandatory Exclusion
- Earned Income Tax Credit

Many taxpayers prefer to care for ill or disabled family members in their homes as opposed to placing them in nursing homes, but doing this can be expensive, time-consuming, and exhausting. The government also recognizes home care as a means of reducing the government's costs in terms of caring for individuals who otherwise would be institutionalized (because they require the type of care that is normally provided in a hospital, nursing facility, or intermediate care facility).

To promote home care and reduce the government's institutional care expenses, Medicaid (through state agencies) pays home caregivers a small wage (usually reported on Form W-2 but sometimes on Form 1099-MISC) referred to as a Medicaid waiver payment to care for an individual in the care provider's home.

The IRS historically has taken the position that these payments were taxable income to the caregiver. However, in a notice issued in 2014, the IRS announced that, if the care met certain requirements, it would no longer challenge the excludability of these wages and instead would treat them in the same manner as excludable difficulty-of-care payments under the foster care payments rule. This is the case even when the caregiver and the individual being cared for are related.

Therefore, the exclusion can be applied to all future years and to all prior open years if the following requirements are met:

- The compensation must be required due to a physical, mental, or emotional handicap with respect to which the State has determined that there is a need for additional compensation.
- The care must be provided in the care provider's home. The "provider's home" may be the care recipient's home if the care provider resides there and regularly performs the routines of the provider's private life, such as sharing meals and holidays with family. In contrast a care provider who sleeps at the care recipient's home several nights a week but on weekends and holidays resides with his or her own family in a separate home would not be providing the care in the care provider's home and would not qualify to exclude the Medicaid waiver payments received.
- The payments must be designated as compensation for qualified foster care or difficulty of care.
- To be excludable, the care payments are limited to a maximum of five individuals age 19 and older or ten individuals age 18 and younger.

Since these payments are now treated the same as qualified foster care difficulty-of-care payments, and since compensation for qualified foster care payments is mandatorily excluded, Medicaid waiver payments are also mandatorily excluded. That is, the care provider receiving these payments may not choose to include them in income.

This change is a double-edged sword, as some lower-income caregivers were previously able to qualify for the earned income tax credit (EITC) based upon this income.

The EITC is a refundable federal tax credit for lower-income taxpayers with earned income. The amount of credit is based on income and increases based on the number of children that the taxpayer has (qualified children include those under age 19 and full-time students under the age of 24; there is no age limit when the child is permanently and totally disabled).

Now, since these Medicaid payments are mandatorily excludable, the compensation no longer counts as earned income for the EITC.

On the other hand, those with substantial other income will welcome the IRS policy change, as it reduces their income and thus their income tax.

Still other care providers—those with earned income from other sources—may benefit from both the reduction of income and the EITC. The EITC phases out for higher-income individuals, so with the

Medicaid waiver payment excluded, these individuals' modified adjusted gross incomes may be reduced enough to qualify for the EITC based on their other earned income. These individuals also may benefit from a lower income tax based upon the exclusion.

As you can see, the impact of the exclusion can be quite different depending upon your particular circumstances. If you are receiving Medicaid waiver payments and have not yet dealt with the exclusion, please call this office to see how excluding these payments might affect you.

Big Business Write-Offs Available

Article Highlights:

- PATH Act
- Section 179 Deductions
- Leasehold Property
- Restaurant Property
- Retail Improvements
- Bonus Depreciation
- Auto and Small Truck First-Year Write-Offs

With the enactment of the Protecting Americans from Tax Hikes (PATH) Act, Congress made two significant business-friendly changes in the tax law, extending bonus depreciation and making the Section 179 deduction's higher expensing amount permanent. This article examines these changes so that you can take full advantage of them in your trade or business.

Section 179 Deduction – This provision allows a business owner or entity to immediately expense, rather than capitalize (depreciate), the cost of new or used tangible property—both personal property and certain real property—placed in service during the tax year. The maximum amount is adjusted annually for inflation and is $500,000 for 2016. However, based on Code Section 179, the maximum amount is reduced dollar-for-dollar by the cost of property placed in service during the tax year in excess of $2,010,000 (for 2016; this is also inflation-adjusted annually).

The PATH Act also dealt with the option to revoke the Section 179 election without the consent of the IRS, making it permanent as well; however, once an election is made and revoked, it becomes irrevocable.

In addition, the PATH Act permanently allows the ability to apply Section 179 expensing to off-the-shelf computer software and qualified real property, which is defined as qualified leasehold or restaurant property and retail improvements. In addition, the $250,000 expense limitation and the carryover limitations have been removed. Finally, air conditioning and heating units are eligible for expensing after December 31, 2015.

Bonus Depreciation – Although the PATH Act did not make bonus depreciation permanent, it extended it through 2019 by slowly phasing it out by reducing the bonus percentage. Bonus depreciation allows businesses to take a depreciation deduction in the first year that the property, which must be acquired new, is placed in service. This depreciation can be for as much as 50% in the years 2012 through 2017 before phasing out in 2018 and 2019; it will no longer be available after 2019 without further Congressional action. The following are the bonus depreciation percentage rates through 2019:

- 50% through 2017,
- 40% for 2018 and

- 30% for 2019.

Bonus depreciation generally applies to property with a class life of no more than 20 years. It also applies to:

- Qualified leasehold property (qualified interior improvement to nonresidential property after the building is placed in service).
- Certain fruit- or nut-bearing plants planted or grafted before January 1, 2020.

Luxury Automobile Rates – Bonus depreciation also impacts the first-year deduction for automobiles and small trucks; in the past, this has added $8,000 to the first-year allowable deduction. Now that the bonus depreciation is being extended and phased out, so is the bonus allowance for automobiles and small trucks. Thus, the luxury auto rates will increase based on the following bonus depreciation rates:

- 2015 through 2017 – $8,000
- 2018 – $6,400
- 2019 – $4,800

If you need assistance regarding strategies for your business's use of the Section 179 expense deduction or bonus depreciation, please call this office.

Can You Deduct Employee Expenses?

Article Highlights:

- Condition of Employment
- Employer Reimbursements
- Miscellaneous Itemized Deductions
- Alternative Minimum Tax
- Home Office
- Computer
- Uniforms and Special Work Clothes
- Education
- Impairment-Related Work Expenses
- Job-Search Expenses

If you are an employee, you may be curious about which expenses relating to your employment are deductible on your tax return. This is a complicated area of tax law, and many expenses are deductible only if the expense is a "condition of employment" or is for the "convenience of the employer," two phrases that are effectively the same.

In addition, other factors affect an employee's ability to deduct expenses incurred as part of employment:

1. If an employer would have paid for or reimbursed the employee for an expense, but the employee chooses not to apply for or take advantage of that reimbursement, the employee cannot take a tax deduction for the expense.
2. Only those employees who itemize their deductions can benefit from business expense deductions. Thus, if you are using the standard deduction, you cannot receive any tax benefit for your job-related expenses. In addition, even when itemizing, miscellaneous itemized deductions must be reduced by 2% of your adjusted gross income (AGI). Employee business expenses fall

into the miscellaneous itemized deduction category. As an example: if your AGI is $80,000, the first $1,600 (2% x AGI) of your miscellaneous deductions provide no benefit.

3. Miscellaneous deductions are not included in the itemized deductions allowed for computing the alternative minimum tax (AMT). Thus, if you are unlucky enough to be subject to the AMT, you will not benefit from your miscellaneous deductions for the extent of the AMT.

The following includes a discussion of the various expenses that an employee might feel they are entitled to deduct and the IRS's requirements for those deductions.

- **Home Office** – An employee can deduct a home office only if his or her use of the home office is for the convenience of the employer. According to the U.S. Tax Court, an employee's use of a home office is for the convenience of his employer only if the employee **must** maintain the home office as a condition of employment. In an audit, the auditor will require a letter from the employer to verify that fact. Most employers are reluctant to make a home office a condition of employment due to labor laws and liability. In addition, an employee would also have to comply with the IRS's strict usage requirements for home offices.

- **Computer** – An individual's property, such as computers, TVs, recorders, and so on, that is used in connection with his or her employment is eligible for expense or depreciation deductions only if that property is required for the convenience of the employer and as a condition of employment. Even if the condition of employment requirement is satisfied, a computer's usage must be prorated for personal and business use.

- **Uniforms and Special Work Clothes -** The cost and maintenance of clothing is allowed if:

  (1) The employee's occupation is one that specifically requires special apparel or equipment as a condition of employment and

  (2) The special apparel or equipment isn't adaptable to general or continued usage (so as to take the place of ordinary clothing).

  Generally, items such as safety shoes, helmets, fishermen's boots, work gloves, oil clothes, and so on are deductible if required for a job. However, other work clothing and standard work shoes aren't deductible—even if the worker's union requires them.

- **Education -** To qualify as job-related, courses must maintain or improve the skills required by the employee's trade or business (such as by helping the employee to meet professional continuing education requirements) or be required as a condition of employment. However, these courses must not be necessary to meet the minimum requirements of the job and must not qualify the employee for a new trade or promotion. If a course meets this definition, its cost is considered deductible as an ordinary and necessary business expense, and as such, it may be excluded from an employee's income if the employer reimburses the employee for its cost. Note: Some education expenses may qualify for more beneficial education credits or an above-the-line-deduction.

- **Impairment-Related Work Expenses** – Taxpayers who have a physical or mental disability that limits their activities can deduct impairment-related work expenses. For example, an allowable expense would be the cost of attendant care at the place of the taxpayer's work.

- **Job-Search Expenses** – Expenses related to looking for a new job in the taxpayer's current occupation are deductible even if a new job is not obtained. To be deductible, the expenses cannot be related to seeking a first job or a job in a new occupation. If there is a substantial time gap between the taxpayer's last job and the time when he or she looks for a new job, the expenses are not deductible.

Of course, all sorts of employee situations exist, including those in which the employee works at his or her local employer's office and those in which the employee lives and works in a remote location. The deductions available to each employee vary significantly based upon that individual's unique situation.

For more information related to employee expenses and what might be deductible in your situation, please give this office a call.

Minimizing Tax on Social Security Benefits

Article Highlights:

- Income as a Factor
- Filing Status as a Factor
- 85% Maximum Taxable
- Base Amounts
- Deferring Income
- Maximizing IRA Distributions

Whether your Social Security benefits are taxable (and, if so, how much of them are) depends on a number of issues. The following facts will help you understand the taxability of your Social Security benefits.

- For this discussion, the term "Social Security benefits" refers to the gross amount of benefits you receive (i.e., the amount before reduction due to payments withheld for Medicare premiums). The tax treatment of Social Security benefits is the same whether the benefits are paid due to disability, retirement or reaching the eligibility age. Supplemental Security Income (SSI) benefits are not included in the computation because they are not taxable under any circumstances.

- How much of your Social Security benefits are taxable (if any) depends on your total income and marital status.

    - If Social Security is your only source of income, it is generally not taxable.

    - On the other hand, if you have other significant income, as much as 85% of your Social Security benefits can be taxable.

    - If you are married and filing separately, and you lived with your spouse at any time during the year, 85% of your Social Security benefits are taxable regardless of your income. This is to prevent married taxpayers who live together from filing separately, thereby reducing the income on each return and thus reducing the amount of Social Security income subject to tax.

- The following quick computation can be done to determine if some of your benefits are taxable:

    Step 1. First, add one-half of the total Social Security benefits you received to the total of your other income, including any tax-exempt interest and other exclusions from income.

    Step 2. Then, compare this total to the base amount used for your filing status. If the total is more than the base amount, some of your benefits may be taxable.

The base amounts are:

- $32,000 for married couples filing jointly;
- $25,000 for single persons, heads of household, qualifying widows/widowers with dependent children, and married individuals filing separately who did not live with their spouses at any time during the year; and
- $0 for married persons filing separately who lived together during the year.

Where taxpayers can defer their "other" income from one year to another, such as by taking Individual Retirement Account (IRA) distributions, they may be able to plan their income so as to eliminate or minimize the tax on their Social Security benefits from one year to another. However, the required minimum distribution rules for IRAs and other retirement plans have to be taken into account.

Individuals who have substantial IRAs—and who either aren't required to make withdrawals or are making their post age 70.5 required minimum distributions without withdrawing enough to reach the Social Security taxable threshold—may be missing an opportunity for some tax-free withdrawals. Everyone's circumstances are different, however, and what works for one may not work for another.

If you have questions about how these issues affect your specific situation, or if you wish to do some tax planning, please give this office a call.

Owe Taxes and Can't Pay?

Article Highlights:

- If you can't pay
- Loans
- Credit card payments
- IRS Installment agreement
- Retirement funds

Are you one of the unfortunate Americans that end up owing and cannot pay your tax liability?

The IRS encourages you to pay the full amount of your tax liability on time by imposing significant penalties and interest on late payments if you don't. So if you are unable to pay the tax you owe, it is generally in your best interest to make other arrangements to obtain the funds for paying your taxes rather than be subjected to the government's penalties and interest. Here are a few options to consider.

- **Family Loan –** Obtaining a loan from a relative or friend may be the best bet because this type of loan is generally the least costly in terms of interest.
- **Credit Card –** Another option is to pay by credit card with one of the service providers that work with the IRS. However, since the IRS will not pay the credit card discount fee, you will have to pay it and pay the higher credit card interest rates.
- **Installment Agreement –** If you owe the IRS $50,000 or less, you may qualify for a streamlined installment agreement where you can make monthly payments for up to six years. You will still be subject to the late payment penalty, but it will be reduced by half. Interest will also be charged at the current rate, and there is a user fee to set up the payment plan. In making the agreement, a taxpayer agrees to keep all future years' tax obligations current. If the taxpayer does not make payments on time or has an outstanding past due amount in a future year, they will be in default of their agreement and the IRS has the option of taking enforcement actions to

collect the entire amount owed. Taxpayers seeking installment agreements exceeding $50,000 will need to validate their financial condition and need for an installment agreement by providing the IRS with a Collection Information Statement (financial statements). Taxpayers may also pay down their balance due to $50,000 or less to take advantage of the streamlined option.

- **Tap a Retirement Account –** This is possibly the worst option for obtaining funds to pay your taxes because you are jeopardizing your retirement and the distributions are generally taxable at your highest bracket, which adds more taxes to your existing problem. In addition, if you are under age
59½, the withdrawal is also subject to a 10% early withdrawal penalty that compounds the problem even further.

Whatever you decide, don't just ignore your tax liability because that is the worst thing you can do. Please call this office for assistance.

Back-Door Roth IRAs

Article Highlights:
- Roth IRA Contribution Limitations
- Converting a Traditional IRA to a Roth IRA
- Circumventing the Limitations
- Back-Door Roth IRAs
- Pitfalls of a Back-Door Roth IRA
- The "All IRAs Are One" Rule

Many individuals who are saving for retirement favor Roth IRAs over traditional IRAs because the former allows for both accumulation and post-retirement distributions to be tax-free. In comparison, contributions to traditional IRAs may be deductible, earnings are tax-deferred, and distributions are generally taxable. Anyone who is under age 70.5 and who has compensation can make a contribution to a traditional IRA (although the deduction may be limited). However, not everyone is allowed to make a Roth IRA contribution.

High-income taxpayers are limited in the annual amount they can contribute to a Roth IRA. The maximum contribution for 2016 is $5,500 ($6,500 if age 50 or older), but the allowable 2016 contribution for joint-filing taxpayers phases out at an adjustable gross income (AGI) between $184,000 and $194,000 (or an AGI between $0 and $9,999 for married taxpayers filing separately). For unmarried taxpayers, the phase-out is between $117,000 and $132,000.

However, tax law also includes a provision that allows taxpayers to convert their traditional IRA funds to Roth IRAs without any AGI restrictions. Although deductible contributions to a traditional IRA have AGI restrictions (for those who are in an employer's plan), nondeductible contributions do not.

Thus, higher-income taxpayers can first make a nondeductible contribution to a traditional IRA and then convert that IRA to a Roth IRA. This is commonly referred to as a "back-door Roth IRA."

BIG PITFALL: However, there is a big pitfall to back-door IRAs, and it can produce unexpected taxable income. Taxpayers and their investment advisers often overlook this pitfall, which revolves around the following rule: For distribution purposes, all of a taxpayer's IRAs (except Roth IRAs) are considered to be one account, so distributions are considered to be taken pro rata from both the deductible and nondeductible portions of the IRA. The prorated amount of the deducted contributions is taxable. Thus, a taxpayer who is contemplating a back-door Roth IRA contribution must carefully consider and plan for the consequences of this "one IRA" rule before making the conversion.

There is a possible, although complicated, solution to this problem. Rolling over IRAs into other types of qualified retirement plans, such as employer retirement plans and 401(k) plans, is permitted tax-free. However, a rollover to a qualified plan is limited to the taxable portion of the IRA. If an employer's plan permits, a taxpayer could roll the entire taxable portion of his or her IRA into the employer's plan, leaving behind only nondeductible IRA contributions, which can then be converted into a Roth IRA tax-free.

Before taking any action, please call this office to discuss strategies for making Roth IRA contributions or to convert existing traditional IRAs into Roth IRAs.

Deducting More Than $250 for Teachers' Classroom Supplies

Article Highlights:

- Above-the-Line Deduction
- Qualifications
- Employee Business Expenses
- Noncash Charitable Contribution
- Noncash Charitable Documentation Requirements

Many devoted teachers spend a significant amount of their own money on classroom supplies. Recognizing this, several years ago, Congress created a special deduction for teachers that would allow them to annually deduct up to $250 on their tax returns for classroom supplies—even if they don't itemize their deductions. This type of deduction is termed an "above-the-line" deduction, and it is available even for taxpayers who claim the standard deduction.

Those who teach kindergarten through grade 12 are eligible for the special $250 deduction. In addition to teachers, those eligible include counselors, principals, and aides who work at least 900 hours during a school year. Because of the 900-hour requirement, many substitute teachers do not qualify for this above-the-line deduction.

However, most conscientious teachers spend far more than $250 for classroom supplies every year. What are the options for teachers who spend more than the $250 on classroom supplies or for teachers and other qualified individuals who do not meet the 900-hour test or other requirements to deduct the $250 above the line?

When eligible, teachers should always claim the above-the-line deduction first; then, they should consider the following possibilities for the excess amount. This advice may also help colleagues who are ineligible for the above-the-line deduction.

Employee Business Expense – One option is to claim expenses for classroom supplies beyond the $250 deduction as employee business expenses, which can be used as a miscellaneous itemized deduction. To claim employee business expenses, the teacher must itemize his or her deductions, which eliminates any benefit for those who use the standard deduction instead of itemizing (usually because the standard allowance is more than the total itemized deductions).

Even for those who itemize, miscellaneous itemized deductions are only deductible to the extent that they exceed 2% of the teacher's adjusted gross income (AGI), so the deductible amount might be wiped out or substantially limited by the AGI reduction. In addition, if the teacher is subject to the alternative minimum tax, some or all of the employee business expense deduction will not be allowed.

Charitable Contribution – According to the tax code, the term "charitable contribution" refers to a contribution or gift for the use of a state, the United States itself, or the District of Columbia—or any political subdivision of any of the foregoing—but only if the contribution or gift is made for exclusively public purposes.

Since public schools are part of a political subdivision of a state, any contribution to a school, in either cash or goods, would be a charitable contribution.

Therefore, a teacher's classroom supplies, **if the teacher properly documents them and if the school provides a written acknowledgment**, would qualify as a noncash charitable contribution. **Caution:** Supplies or equipment that the teacher retains are not considered a completed gift, and their cost does not qualify as a charitable contribution. For example, if a science teacher purchases a microscope that students use in the classroom, but the teacher then keeps it for personal use when the school year ends, the cost of the microscope would not be deductible as a charitable contribution.

To meet the requirements for noncash contributions, the teacher claiming the contribution must obtain and keep an acknowledgment from the school; the contents of this acknowledgement are based upon the value of the contribution claimed, as detailed below. The acknowledgment must be in the taxpayer's possession before he or she files a return for the year in which the contribution was made, or before the due date (including extensions) for filing that return, whichever is earlier.

- *Deductions of Less Than $250* **–** These acknowledgments must include
    1. the name of the charitable organization,
    2. the date and location of the charitable contribution, and
    3. a reasonably detailed description of the property.

- *Deductions of at Least $250 but Not More Than $500* **–** These acknowledgments must include
    1. the name of the charitable organization,
    2. the date and location of the charitable contribution,
    3. a reasonably detailed description (but not necessarily the value) of any property contributed, and
    4. whether the qualified organization gave the taxpayer any goods or services as a result of the contribution (other than certain token items and membership benefits).

  If the taxpayer received goods and/or services in return, the acknowledgement must also include a description and good-faith estimate of their value. (The portion of the donation attributable to the goods and services that the taxpayer received is not deductible.)

- *Deductions Over $500 but Not Over $5,000* **–** A taxpayer claiming a deduction over $500 but not over $5,000 for a noncash charitable contribution must have the same acknowledgement and written records as for the contributions described in the previous section (for donations of at least $250 but not more than $500). In addition, the records must include
    1. how the property was obtained (for example, by purchase, gift, bequest, inheritance, or exchange);
    2. the approximate date when the property was obtained or (if created, produced, or manufactured by the taxpayer) substantially completed; and
    3. the cost or other basis (and any adjustments to that basis) of property held for less than 12 months and (if available) the cost or other basis of property held for 12 months or more.

- *Deductions Over $5,000* **–** There are additional requirements for noncash contributions of this size, including certified appraisals. However, the details are not included here.

If you have additional questions related to deducting classroom supplies, please give this office a call.

Deducting Startup Costs for Your New Business at Tax Time

Before you earn your first dollar, before you are even open for business, your startup can incur considerable expenses. The money you spend opening your business can often be deducted; the IRS allows you to deduct many of these one-time startup costs. Speaking with an accountant in the early stages can help you decide which of these deductions to take – and may also help you discover additional ways to save money as you operate your new startup. There are several types of startup costs that may be deductible for your new business.

Preparing your business
The costs associated with training employees, hiring consultants, early advertising and marketing to generate interest, and even the costs associated with sourcing suppliers and locations can all be deducted. If you have to hire and train employees to work in your business, but are not yet open to customers, then you can usually deduct these costs at tax time.
If you are researching the feasibility of a business, testing the market, creating prototypes or analyzing production costs, these expenditures are generally deductible as well for your startup. These costs count only if you actually begin a business. If you research or dabble and then change your mind, you usually cannot deduct these costs.

Organizational costs
If you are incorporating, setting up a partnership or incurring expenses as you legally set up your new business, you can likely deduct these costs as well. Incorporation fees, legal fees, accounting fees and filing fees can often be deducted from your first year costs but may also be amortized over the lifetime of your business. An accounting professional can help you learn more about your options and discover which method is best for your particular circumstances.

What about equipment costs?
From kitchen appliances to office equipment and even machinery, you'll likely have to spend some cash to get up and running, but your equipment purchases are not deductible as part of your startup and cannot be deducted until actually placed in business service (use). Thus the equipment you buy to use when your business becomes operational is not included in the startup costs by the IRS; these items are generally considered assets, and must be capitalized and depreciated or written off in the first year using the Sec 179 expense deduction.

How much of your startup costs can be deducted?
While the IRS does allow you to deduct some startup costs, there are limits to what you can deduct in your first year. For most entrepreneurs with startup costs of $50,000 or less, up to $5,000 in startup costs and $5,000 of organizational expenses can be deducted in the first year. Each of the $5,000 amounts is reduced by the amount by which the total start-up expense or organizational expense exceeds $50,000. Startups with more than $55,000 in costs won't be able to claim either $5,000 deduction in the first year. Start-up and organizational expenses not deductible in the first year of the business must be amortized over 15 years.

A professional familiar with startups can help you determine which of your costs can be deducted and help you find the right path for your new business. The decisions you make as you start your business will have a long-term impact on your operating costs and bottom line for years to come; choose wisely at the outset for the best possible start for your new company.