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Oops, Did You Forget Something on a Tax Return?

Article Highlights:

- Overlooked Deductions and Credits
- Amended Tax Documents
- Overlooked Income
- Filing Statute of Limitations

If you have already filed your tax return and overlooked an item of income or forgot to claim a deduction or credit, it is not too late! An amended return can be filed to correct an already filed tax return. Failing to report an item of income will most certainly generate an IRS inquiry, which typically happens a year or more after the original return was filed and after the interest and penalties have built up. Therefore, it is best to file an amended return as soon as possible to avoid the headache of IRS correspondence and to minimize the interest and penalties on any additional tax you might owe.

On the flip side, if you overlooked a significant deduction or tax credit and you have a refund coming, you certainly don't want that to go by the wayside.

The solution is to file an amended return as soon as the error or omission is discovered. Amended returns can also be used to claim an overlooked credit, correct the filing status or the number of dependents, report an omitted investment transaction, submit information from delayed K-1s, or anything else that should have been reported on the original return.

If the overlooked item will result in a tax increase, penalties and interest can be mitigated by filing an amended return as soon as possible. Procrastination leads to further complications once the IRS determines something is missing, so it is best to take care of the issue right away.

Generally, to claim a refund, an amended return must be filed within three years from the date the original return was filed or within two years from the date the tax was paid, whichever is later.

If any of the above applies to your situation, please give this office a call so we can prepare an amended tax return for you.

Employers, Don't Miss the Work Opportunity Tax Credit

Article Highlights:

- Credit is Elective
- Credit Amount
- Work Hours Requirements
- Targeted Groups
- Limitations
- Certification Requirement

Through 2019, employers who hire individuals from targeted groups are qualified to claim the work opportunity tax credit (WOTC). The credit is elective, and if claimed it reduces the employer's wage deduction dollar for dollar.

The credit is a percentage of the employee's first-year wages, generally up to $6,000 per eligible employee, paid during the tax year for work performed during the one-year period beginning on the date the target group member begins work for the employer.

This provides a tax credit worth as much as $2,400 for each eligible employee (and up to $4,800, $5,600 or $9,600 for certain veterans or $9,000 for "long-term family assistance recipients").

For the full credit (40%), the targeted employee must work for a minimum of 400 hours in the first year. For those that work between 120 and 399 hours, the credit percentage is reduced to 25%.

Targeted groups after 2015 include qualified:

- **Veterans** - the first-year wages considered for this group vary between $12,000 and $24,000 with a maximum credit between $4,800 and $9,600 per employee, depending on the period of unemployment, whether he or she is receiving service-connected disability payments, and when he or she was discharged from active duty service.
- **Long-term unemployed individuals** (unemployed for 27 consecutive weeks)
- **Ex-Felons**
- **Recipients of Temporary Assistance for Needy Families** (TANF) program
- **Designated community residents**
- **Vocational rehabilitation referrals**
- **Summer youth employees** – Special rules apply – The credit is 40% for up to $3,000 of wages paid during any 90-day period between May 1 and Sept. 15, for a maximum credit of $1,200 ($3,000 × 40%) per employee.
- **Supplemental nutrition assistance benefits recipients**
- **SSI recipients**
- **Long-term family assistance (TANF) recipients** – The first-year wages considered for this group amount to $10,000 with a maximum credit of $4,000 per employee. In addition, this group qualifies for a second-year credit equal to 50% of up to $10,000 of the second-year wages.

Before claiming the credit, an employer must obtain certification that an individual is a member of the targeted group. This is done by filing Form 8850, Pre-Screening Notice and Certification Request for the Work Opportunity Credit, with the employer's respective state workforce agency (Designated Local Agency) within 28 days after the eligible worker begins work, although additional time is provided in some cases.

Claiming the WOTC may also impact the availability of certain other employment-related tax credits. The credit is generally not available for employment of prior employees, certain family members, replacements for employees on strike or locked out and employees who are receiving federally funded on-the-job training. This credit is part of the general business credit and subject to its limitations and carryover provisions.

Please call this office for additional information or assistance in applying for employee credit certification.

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.

Time-Share Use as a Charitable Contribution

Article Highlights:

- Charity Auction
- Time-Share Donation

- Use of Property as a Donation
- Time-Share Maintenance Fees
- Taxpayer-Rendered Services

If you have ever attended a charity auction, it is not uncommon to see a week's use of a time-share included in the items donated for auction. The time-share owners who donate these weeks generally do so in anticipation of being able to take charitable donation deduction on their tax returns.

How does one determine how much one can deduct for such a donation? The answer may come as a surprise. Per an IRS revenue ruling(1), the use of a property, or the permission to use and occupy a property, does not constitute a gift of property. In addition, the Internal Revenue Code does not allow a charitable deduction for a gift of a partial interest in a property unless this is done in trust(2). Therefore, no charitable contribution deduction is allowed for the use of a time-share property.

Time-share owners are generally required to pay an annual maintenance fee that covers the pro rata upkeep of the resort itself, plus housekeeping services. The question arises: Can the time-share owner deduct the maintenance fee for the week donated?

IRS regulations (3) allow deductions for expenses incurred in connection with personally rendered services to a qualified organization. However, services provided by others, even if paid for by the taxpayer, are not personally rendered to the charity and thus are not deductible. Since this includes the services provided by the time-share management company that are paid for with the taxpayer's maintenance fees, the time-share's maintenance fees for the donated period are not deductible.

However, if the taxpayer incurred other expenses in connection with the donated use of the time-share, such as driving to the time-share property to let the winning bidder into the unit, a deduction for those expenses would be allowed under IRS regulations (3). This is because the time-share owner would be performing the service directly for the charitable organization; a mileage deduction at the rate of 14 cents per mile would be allowed.

As a bottom line, the donation of the use of a time-share does not constitute a charitable contribution. If you have questions related to charitable contributions please give this office a call.

Receiving Cash Tips? The IRS Is Watching

Article Highlights:

- Collecting Tips
- Tip Splitting
- Service Charges
- Record Keeping
- Employer Reporting
- Allocated Tips

Anyone who collects tips must include them in their taxable income. This requirement is not limited to waiters and waitresses; it applies to anyone who collects tips, including taxicab drivers, beauticians, porters, concierges, etc.

Tips are amounts freely given by a customer to a person providing a service. They are generally given as cash, but they include tips made on a credit or debit card or as part of a tip-sharing arrangement. Tips can also be in the form of non-traditional gifts such as tickets to events, wine and other items of value. If you receive $20 or more in tips in any month, you should report all of your tips to your employer, with these exceptions:

- **Tip-splitting —** Tips you give to others under a tip-splitting arrangement are not subject to the reporting requirement by you (the employee initially receiving them). You should report to your employer only the net tips you received.
- **Service (cover) charges** — These are charges arbitrarily added by the business establishment (employer) — for example, a specific percentage of the bill for parties exceeding X in number — and are excluded from the tip-reporting requirements. If your employer collects service charges from customers, your share of these charges, as determined by your employer, is taxable to you and should already be included as part of your wages.

Keep a running daily log of tip income — Tips are a frequently audited item, and it is a good practice to keep a daily log of your tips. The IRS provides a log in Publication 1244 that includes an *Employee's Daily Record of Tips* and a *Report to Employer* for recording your tip income.

Report tips to your employer — If you receive $20 or more in tips in any month, you should report all of your tips to your employer. Your employer is required to withhold federal income, Social Security, and Medicare taxes. If the tips received are less than $20 in any month, don't think you are off the hook; although they need not be reported to the employer, these tips are still taxable and must be reported on your tax return, as they are subject to income, Medicare and Social Security taxes.

Employer allocation of tips — If you work for a large restaurant, you may find when you get your W-2 form that you got tips you didn't know about. Restaurants with a large serving staff report a total called "allocated tips" to the IRS. Here is what allocated tips are all about:

> Tip allocation applies to "large food and beverage establishments" (i.e., food service businesses where tipping is customary and that have 10 or more employees). These establishments must allocate a portion of their gross receipts as tip income to those employees who "underreport," which happens if an employee reports tips that are **less than 8%** of the employee's share of the employer's gross sales. The employer must allocate to those underreported employees the difference between what the employee reported and the 8% amount.
>
> If this situation applies to you, the allocation amount will be noted in a separate box on your W-2, and these allocated tips won't be included in the total wages shown on your W-2 form. You will need to report the allocated tip amount as additional income on your tax return unless you have adequate records to show that the amount is incorrect. The IRS frequently issues inquiries where the taxpayer's W-2 shows an allocation of tips and a lesser amount is reported on the tax return.

Self-Employed Individuals – If you are self-employed, you don't have an employer to report tips to, and you simply include the tips you've received in your self-employed income on your tax return for the year you received the tips.

Because they are usually paid in cash, tips are a frequent audit item. If you are receiving tips and have any questions, please give this office a call.