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Cutting the IRS Out of Your Gifts

Article Highlights:

- Gift Tax Rule
- Annual Exemption
- Lifetime Exemption
- Medical and Tuition Exemptions
- Gift Splitting
- Gifts of Property

If you are financially well off, you may want to gift money or property to family members or others you care about. If that is the case, there are some gift tax issues you should be aware of. Oh yes, the government even taxes gifts if they are large enough, so it is best to know the rules; otherwise you may end up making a gift of taxes to the IRS.

The gift tax rules provide two exclusions from gift tax, the annual exclusion and the lifetime exclusion:

Annual Exclusion – The annual exclusion is periodically inflation adjusted and is currently $14,000 per individual. Thus you can give $14,000 a year to as many individuals as you wish without any gift tax or gift tax return filing requirements.

Lifetime Exclusion – On top of the annual exclusion, there is a lifetime exclusion that is linked to the estate tax exemption, which is also inflation adjusted, and for 2016 is $5.45 Million. Thus, in addition to the $14,000 annual per donee exclusion, there is a $5.45 Million exclusion that applies to the aggregate of all gifts in excess of the $14,000 per year per donee gifts.

There are complications to utilizing the lifetime exclusion. You must file a gift tax return to claim the lifetime exclusion, and the amounts of the lifetime exclusion used as an exclusion from gift tax will be tracked on any gift tax return(s) filed and will reduce the estate tax exemption. So for example, if in 2016 you make a gift of $3,014,000 to your child, and you haven’t made gifts in the past that exceeded the annual per donee gift tax exclusion, you will pay no gift tax, but you will have reduced your remaining lifetime exclusion to $2.45 Million. If you make more large gifts in the future that use up your remaining lifetime exclusion, not only will you then be subject to gift tax on the excess gifts, but at your passing, and assuming the value of your estate is large enough to be subject to estate tax, you will have no estate tax exclusion left to offset the estate’s value, so it will all be subject to estate tax.

CAUTION

The estate tax rates and the lifetime exclusion have long been a political football. They date back to 2006, when the lifetime exclusion was $2 Million. Congress can change the current $5.45 Million exclusion at any time. In fact, Democratic presidential candidate Hillary Clinton has proposed reducing the exclusion to $3 Million and raising the top estate tax rate from 40% to 45%. She would also disconnect the gift and estate tax exclusions and limit the lifetime gift exclusion to $1 Million.

<u>Special Tuition/Medical Exclusion</u> **-** In addition to the current $14,000 annual exclusion, a donor may make gifts that are totally excluded from the gift tax in the following circumstances:

- Payments made **<u>directly</u>** to an educational institution for tuition. This includes college and private primary education. It does not include books or room and board.
- Payments made **<u>directly</u>** to any person or entity providing medical care for the donee.

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

<u>Gift Splitting</u> **-** A husband and wife can each make annual exclusion gifts, thereby increasing the exclusion from the current $14,000 to $28,000 per year per couple. However, only one of the spouses may be in a financial position to make the gifts. Spouses may elect on the gift tax return to treat a gift made by one spouse as being made by both spouses. Gift splitting can be used for annual exclusion gifts, lifetime exclusion gifts, and gifts above the lifetime exclusions.

> ***Example - Gift Splitting -*** *John and Jane are married and have two children. In a year when the annual exclusion limit is $14,000, they would like to exclude $56,000 ($14,000 x 2 donors x 2 donees) in gifts. Jane received a large inheritance some years back; John has only a modest estate. Jane gives the children $28,000 each. Then the couple elects to gift split so that the $28,000 gift is treated as given one-half by Jane and one-half by John (or $14,000 each). The gifts all qualify for the annual exclusion. Even if both spouses have sufficient resources to make gifts, gift splitting is useful when the husband and wife have different estate planning goals.*

For residents of community property states, if community property is given, gift splitting is not necessary. Regardless of who holds the property's title, or who "makes" the gift, the property is owned one-half by each and is therefore given one-half by each.

<u>Gifts of Property</u> – Gifts of property have some of their own circumstances to consider. For instance, where gifts are made of appreciated property such as stocks or real estate, although the donor's gift is considered at the fair market value (FMV) for purposes of valuing the gift, the beneficiary of the gift assumes the donor's basis. As a result, the beneficiary of the gift is assuming any taxable gain the donor would have had if he or she had sold the property instead of gifting it and will have to include as income that gain when and if the gifted property is later sold.

Although the FMV of traded stocks is readily available, the same is not true of most other types of property, in which case a qualified appraisal will be needed to determine the value as of the date of the gift.

Finally, keep in mind that a beneficiary inherits property at its FMV at the date of the decedent's death as opposed to assuming the decedent's basis, as happens in the case of a gift.

If you are contemplating gifting money or property to an individual, it may be appropriate to consult this office in advance to minimize the impact on estate taxes and help with any gift tax filings that may be required.

Don’t Be Left Holding the Tax Bag

Article Highlights:

- Paying Independent Contractors
- 1099-MISC Reporting Threshold
- Form W-9 Benefits
- Penalties
- Due Date

If you use independent contractors in your business and pay them $600 or more during the calendar year, you are required to issue them a 1099-MISC after the close of the year. If you fail to do so, and your (if you operate as a Schedule C sole proprietor) or your business’s income tax return is subsequently audited, you could lose the deduction for those payments and end up paying taxes on that income yourself, not to mention potential penalties.

A big tax trap for businesses is the $600 reporting threshold. Say your business uses the services of an independent contractor early in the year at a cost below the $600 threshold, and you don’t bother to obtain the necessary reporting information from the contractor. If you use the contractor's services again later in the year and the combined total you’ve paid him or her exceeds the reporting threshold, you won't have the required reporting information.

Sorry to say, you may find it difficult to obtain that information after the fact, as not all self-employed individuals report all their income, and contractors may not be willing to give you their tax ID information once they’ve completed the work and gotten your payment for their services. So, it is good practice to collect that information upfront before engaging the contractor regardless of the amount.

The IRS provides Form W-9 – Request for Taxpayer Identification Number and Certification – as a means for you to obtain the data required from your vendors in order to file the required 1099-MISC forms after the close of the year. A completed W-9 also provides you with verification that you complied with the law should the vendor provide you with incorrect information.

In addition, there are substantial penalties if you fail to file a correct 1099-MISC by the due date and you cannot show reasonable cause for not filing. Generally, for 1099 forms due in 2017, the penalty is $50 per 1099-MISC for not filing by the due date. The penalty increases to $100 if the form is not filed within 30 days of the due date and $260 after August 1, 2017. The maximum penalty for small businesses is $532,000, so you can see this is not a reporting requirement to be taken lightly.

Oh, and by the way, the due date for filing 2016 Forms 1099-MISC with the IRS is January 31, 2017, when you are reporting nonemployee compensation (box 7 of the form), which includes the income paid to independent contractors. This due date is a month (two months if you’ve been filing your 1099s electronically) earlier than it has been in the past. So now both the government’s copy and the one you provide the contractor are due by the same date.

If you have questions related to your 1099-MISC reporting requirements or need assistance filing the required forms after the end of the year, please give this office a call.

Who Claims the Kids? You or Your Ex-Spouse?

Article Highlights:

- Custodial Parent
- Dependency (Exemption) Release
- Joint Custody
- Tiebreaker Rules
- Child's Exemption
- Head of Household Filing Status
- Tuition Credit
- Child Care Credit
- Child Tax Credit
- Affordable Care Act
- Earned Income Tax Credit

If you are a divorced or separated parent with children, a commonly encountered but often-misunderstood issue is who claims the child or children for tax purposes. This is sometimes a hotly disputed issue between parents; however, tax law includes some very specific but complicated rules about who profits from the child-related tax benefits. At issue are a number of benefits, including the children's dependency tax exemption, child tax credit, child care credit, higher-education tuition credit, earned income tax credit, and in some cases even filing status.

This is actually one of the most complicated areas of tax law, and serious mistakes can be made by taxpayers preparing their own returns or inexperienced tax preparers, especially if the parents are not communicating well. Where parents will cooperate with each other, they often can work out the best tax result overall, even though it may not be the best for them individually, and compensate for it in other ways.

Where a family court awards physical custody of a child to one of the parents, tax law is very specific in awarding that child's dependency to the parent with physical custody, regardless of the amount of child support provided by the other parent. However, the custodial parent may release the dependency (exemption) to the non-custodial parent by completing the appropriate IRS form.

> **CAUTION** - The decision to relinquish the dependency should not be taken lightly, as it impacts a number of tax benefits.

On the other hand, if the family court awards joint physical custody, only one of the parents may claim the child as a dependent for tax purposes. If the parents cannot agree between themselves as to who will claim the child and the child is actually claimed by both, the IRS tiebreaker rules will apply. Per the tiebreaker rules, the child is treated as a dependent of the parent with whom the child resided for the greater number of nights during the tax year, or if the child resides with both parents for the same amount of time during the tax year, the parent with the higher adjusted gross income claims the child as a dependent.

Child's Exemption - The parent who claims the child as a dependent is entitled to the child's tax exemption – which is actually a deduction from income of $4,050 in 2016. However, the exemption begins to phase out for higher-income taxpayers with an AGI of $259,400 for single taxpayers, $285,350 for those qualifying for head of household filing status and $311,300 for married taxpayers filing jointly.

Head of Household Filing Status – An unmarried parent can claim the more favorable head of household, rather than single, filing status if the parent is the custodial parent and pays more than one-half of the cost of maintaining as his or her home a household which is the principal place of abode for more than one-half the year for that child. This is true even when the child's dependency (and therefore the $4,050 exemption deduction) is released to the non-custodial parent.

Tuition Credit – If the child qualifies for either the American Opportunity or the Lifetime Learning higher-education tax credit, the credit goes to whoever claims the child's exemption. Credits are significant tax benefits because they reduce the amount of tax dollar-for-dollar, while deductions reduce income to arrive at taxable income that is then taxed according to the individual's tax bracket. For instance, the American Opportunity Tax Credit (AOTC) provides a tax credit of up to $2,500, 40% of which is refundable. However, both education credits phase out for higher-income taxpayers. For instance, the AOTC phases out between $65,000 and $80,000 for unmarried taxpayers and $130,000 and $160,000 for married taxpayers.

Child Care Credit - A nonrefundable tax credit is available to the custodial parent for the care of the child while the parent is gainfully employed or seeking employment. To qualify for this credit, the child must be under the age of 13 and be a dependent of the parent. However, a special rule for divorced or separated parents provides that where the custodial parent releases the child's exemption to the non-custodial parent, the custodial parent would still qualify to claim the childcare credit, and it cannot be claimed by the noncustodial parent.

Child Tax Credit – A credit of $1,000 is allowed for a child under the age of 17. That credit goes to the parent claiming the child as a dependent. However, this credit phases out for higher-income parents, beginning at $75,000 for unmarried parents and $110,000 for married parents filing jointly.

Affordable Care Act – Parents must keep in mind that where the child does not have medical insurance during periods of the year, the parent claiming the child as a dependent (claims the $4,050 exemption) is the one responsible for any applicable penalties when the child does not have health insurance coverage.

Earned Income Tax Credit (EITC) – Lower-income parents with earned income (wages or self-employment income) may qualify for the EITC. This credit is based on the number of children (under age 19 or a full-time student under age 24) the custodial parent has, up to a maximum of three children. Releasing the dependency exemption to the noncustodial parent will not disqualify the custodial parent from using the children to qualify for the EITC. In fact, the noncustodial parent is prohibited from claiming the EITC based on the child or children whose exemption has been released by the custodial parent.

As you can see, there are some complex rules that apply to the tax benefits provided by children of divorced parents. It is highly recommended that you consult this office for the preparation of your return. If you are the custodial parent you should also consult with this office before making the decision to release a child's exemption.

Taking Advantage of Back-Door Roth IRAs

Article Highlights:

- Roth IRA High Income Phaseout
- Traditional-to-Roth IRA Conversions
- Non-deductible Traditional IRA Contributions
- Back-door Roth IRA
- Pitfall of Traditional-to-Roth Conversions

If you are a high-income taxpayer and would like to contribute to a Roth IRA but cannot because of income limitations, there is a work-around that will allow you to fund a Roth IRA.

High-income taxpayers are limited in the annual amount they can contribute to a Roth IRA. In 2016, the allowable contribution phases out for joint-filing taxpayers with an AGI between $184,000 and $194,000 (or an AGI between $0 and $9,999 for married taxpayers filing separately). For unmarried taxpayers, the phaseout is between $117,000 and $132,000. Once the upper end of the range is reached, no contribution is allowed for the year.

However, those AGI limitations can be circumvented by what is frequently referred to as a back-door Roth IRA. Here is how a back-door Roth IRA works:

1. First, you contribute to a traditional IRA. For higher-income taxpayers who participate in an employer-sponsored retirement plan, a traditional IRA is allowed but is not deductible. Even if all or some portion is deductible, the contribution can be designated as not deductible.
2. Then, since the law allows an individual to convert a traditional IRA to a Roth IRA without any income limitations, you now convert the non-deductible Traditional IRA to a Roth IRA. Since the Traditional IRA was non-deductible, the only tax related to the conversion would be on any appreciation in value of the Traditional IRA before the conversion is completed.

Potential Pitfall – There is a potential pitfall to the back-door Roth IRA that is often overlooked by investment counselors and taxpayers alike that could result in an unexpected taxable event upon conversion. For distribution or conversion purposes, all of your IRAs (except Roth IRAs) are considered as one account and any distribution or converted amounts are deemed taken ratably from the deductible and non-deductible portions of the traditional IRA, and the portion that comes from the deductible contributions would be taxable.

This may or not may affect your decision to use the back-door Roth IRA method but does need to be considered prior to making the conversion.

There is a possible, although complicated, solution. Taxpayers are allowed to roll over or make a trustee-to-trustee transfer of IRA funds into employer qualified plans if the employer's plan permits. If the rollover or transfer to the qualified plan is permitted, such rollovers or transfers are limited to the taxable portion of the IRA account, thus leaving behind the non-taxable contributions, which can then be converted to a Roth IRA without any taxability.

Please call this office if you need assistance with your Roth IRA strategies or need assistance in planning traditional-to-Roth IRA conversions.

Thinking of Converting Your Home to a Rental? Better Read this First

Article Highlights:

- Home Gain Exclusion
- Converting Homes that Have Declined in Value
- Converted Basis
- Passive Loss Limitations

If you are considering converting your home to a rental, there are a number of tax issues you need to consider before making a final decision.

One of the first issues to consider is that by converting your main home to a rental, you may be giving up an opportunity to realize tax-free income. Currently, taxpayers are allowed to exclude $250,000 ($500,000 for married taxpayers filing jointly) of home gain when they sell a home if they owned and occupied the home as a primary residence two of the five years prior to the sale. Once converted, the property is no longer your primary residence, and if you sell it more than three years after the conversion, any gain would no longer qualify for the home gain exclusion and would be fully taxable.

Not all homes will have appreciated in value, and in some cases, as we've seen over the last few years, some homes may have declined in value from the time they were purchased. If a primary residence is sold at a loss, that loss is not deductible for tax purposes because losses are never allowed for personal use property.

Some homeowners have the mistaken belief that if they convert their home that has declined in value to rental use, they can then deduct a loss when they sell the property, which is not the case.

When a residence or other nonbusiness property is converted from personal use to business use, such as a rental, it needs to be appraised by a certified real estate appraiser, and that appraised value is the value (basis) from which a loss is determined when the property is subsequently sold. In other words, any loss attributable to the period it was a personal use property is not allowed.

However, for purposes of computing gain, the value (basis) from which gain is measured is the original cost of the home plus improvements less any depreciation claimed.

If your decision is to convert the home to a rental, the rental period begins when you actually make the home available for rent, which is generally the date you advertise the property for rent. From this point on the depreciation, mortgage interest, property taxes, other taxes, utilities, repairs, advertising and other expenses are reported along with rental income on Schedule E of the 1040.

Rentals are considered passive activities, and generally losses from passive activities can only offset gains from passive activities. However, there is a special rule that allows up to $25,000 of losses from rental real estate activities to be deductible annually. However, that special loss allowance phases out ratably for taxpayers with AGIs between $100,000 and $150,000, and once the top of the phaseout range is reached, no loss is allowed. However, in this case, the loss that can't be deducted can be carried over to future years. That carryover may not do much good year by year for someone whose AGI is consistently over the top of the phaseout range, until the year the property is sold and the suspended losses are released and can be deducted.

For more details related to converting your home to rental use and applying the rules to your specific situation, please give this office a call.

Little-Known Tactic Increases Child Care Credit

Article Highlights:

- Social Security Benefits
- Child Care Credit
- Partnership
- Joint Venture
- Material Participation
- Retirement Benefits

When both spouses in a married couple are jointly involved in the operation of an unincorporated business (generally a Schedule C), it is fairly common – but incorrect – for all of that business's income to be reported as just one spouse's income, even when they both work in the business.

In such cases, the spouse not taking credit for his or her portion of the earned income loses out on the chance to accumulate his or her own eligibility for Social Security benefits. In addition, to claim a child care credit, both spouses on a joint return must have earned income (or imputed income if one of the spouses is a full-time student or is disabled), so unless the spouse not including a portion of the income from the joint business has another source of earned income, the couple will not be allowed a child care credit.

There are ways to remedy this situation, however. One option is to file a partnership return for the activity, in which case each spouse will receive a K-1 that reports his or her share of the net profit. An approach that avoids the necessity of filing a partnership return, and that is probably less complicated, is a qualified joint-venture election, in which each spouse elects to file a separate Schedule C for his or her respective share of the business. This gives them both self-employed income for the purposes of the self-employment tax and for claiming the child care credit.

A qualified joint venture refers to any joint venture involving the conduct of a trade or business if:

(1) The only members of the joint venture are husband and wife,
(2) Both spouses materially participate in the trade or business, and
(3) Both spouses elect to apply this rule.

Generally, to meet the material participation requirement, each spouse will have to participate in the activity for 500 hours or more during the tax year.

If the net income from the business exceeds the annual cap on income subject to the Social Security tax, the combined self-employment tax for the spouses with split Schedule Cs will exceed what a single spouse would have paid if he or she had filed a single Schedule C.

An additional benefit when filing split Schedule Cs is the opportunity for both spouses to participate in IRAs and self-employed retirement plans.

If you have questions about how splitting the business income between spouses might apply to your specific situation, please contact this office.

So You Want to Deduct Your Work Clothes; Better Read This

Article Highlights:

- Condition of Employment
- Not Suitable for Everyday Wear
- Uniforms
- Protective Clothing
- Military
- Miscellaneous Deduction

A frequent question that arises is: Can I deduct the cost of my work clothing on my tax return? The answer to that question is "maybe." The IRS provides the following guidelines for when expenses for work clothes are deductible:

1) They are worn as a condition of employment, AND

2) The clothing is not suitable for everyday wear.

It is not enough that the clothing be distinctive; it must be specifically required by the taxpayer's employer. Nor is it enough that the taxpayer does not, in fact, wear the work clothes away from work. The clothing must not be suitable for taking the place of the taxpayer's regular clothing. So, just because your employer requires you to wear a suit at work does not make that suit deductible, because it is suitable for everyday wear.

The following are examples of workers who may be able to deduct the cost and upkeep of work clothes: delivery workers, firefighters, health care workers, law enforcement officers, letter carriers, professional athletes, and transportation workers (air, rail, bus, etc.). Note that those types of occupations usually require uniform-type clothing, which is generally deductible if required by the employer.

Musicians and entertainers can deduct the cost of theatrical clothing and accessories <u>if they are not suitable for everyday wear</u>. The IRS contends that white bib overalls and standard shoes, such as a painter might wear, are not distinctive in character or in the nature of a uniform, so they are not deductible.

Generally, when deciding whether costs to purchase and maintain clothing are eligible to be deducted, the courts use an objective test that makes no reference to the individual taxpayer's lifestyle or personal taste. Instead, the courts in considering whether clothing is adaptable for personal or general use look to what is generally considered ordinary street wear.

For example, in a recent Tax Court case, the court held that a salesman for Ralph Lauren who was required to purchase and wear the designer's apparel while representing the company couldn't deduct the cost of such clothing. The court found that the clothing was clearly suitable for regular wear and therefore not deductible.

<u>*Protective Clothing*</u> - The costs of protective clothing required for work, such as safety shoes or boots, safety glasses, hard hats and work gloves, are deductible. Examples of workers who may require safety items include carpenters, cement workers, chemical workers, electricians, fishing workers, linemen, machinists, oil field workers, pipe fitters and truck drivers.

<u>Military Uniforms</u> **-** Taxpayers generally cannot deduct the cost of uniforms if they are on full-time active duty in the armed forces. However, armed forces reservists can deduct the unreimbursed cost of uniforms if military regulations restrict the taxpayers from wearing a uniform except while on duty as a reservist. A student at an armed forces academy cannot deduct the cost of uniforms if they replace regular clothing. However, the cost of insignia, shoulder boards, and related items are deductible. Civilian faculty and staff members of a military school can deduct the cost of uniforms.

When deductible, the cost of the clothing and upkeep is considered a miscellaneous itemized deduction. However, miscellaneous itemized deductions are only allowed to the extent that they exceed 2% of your adjusted gross income. So higher-income taxpayers with no or few other miscellaneous itemized deductions may not benefit from a deduction.
Please contact this office if you have any questions about the deductibility of work clothing.

Higher Income Taxpayers Hit with Exemption & Itemized Deductions Phaseout

Article Highlights:

- Phaseout Thresholds
- Personal Exemption Phaseout

- Itemized Deduction Phaseout
- Phaseout Example

Generally, in 2016 and 2017 taxpayers are allowed to deduct personal exemptions of $4,050 for themselves, their spouses and their dependents. In addition, taxpayers are allowed a standard deduction or, if their deductions are large, they can itemize their deductions.

However, the personal exemptions and itemized deductions for higher income taxpayers are phased out beginning when a taxpayer's adjusted gross income (AGI) reaches a phaseout threshold amount.

The threshold amounts are based on the taxpayer's filing status, and for 2017 they are $261,500 (up from $259,400 for 2016) for single filers, $287,650 (up from $285,350 for 2016) for individuals filing as heads of households, $313,800 (up from $311,300 for 2016) for married couples filing jointly and $156,900 (up from $155,650 for 2016) for married individuals filing separately. Here is how the phaseout works:

- **Personal Exemption** - The otherwise allowable exemption amounts are reduced by 2% for each $2,500 or part of $2,500 ($1,250 for a married taxpayer filing separately) that the taxpayer's AGI exceeds the threshold amount for the taxpayer's filing status.

  Example: *Ralph and Louise have an AGI of $426,300 for 2017 and two children for a total of four exemptions totaling $16,200 (4 × $4,050). The threshold for a married couple is $313,800; thus, their income exceeds the threshold by $112,500. Dividing $112,500 by $2,500 equals 45. So 90% (45 × 2%) of their $16,200 exemption allowance is phased out, leaving them with a reduced exemption deduction of $1,620 ((100%–90%) × $16,200). Assuming Ralph and Louise are in the 33% federal tax bracket, the phaseout costs them an additional $4,811 ($16,200 × 90% × 33%) of tax.*

  A divorced or separated parent subject to the phaseout should consider relinquishing the exemption of a dependent child to the other parent. Where a taxpayer is a party to a multiple support agreement, the taxpayer may want to allow another contributing member of the agreement who is not hit by the phaseout to claim the dependent's exemption.

- **Itemized Deductions** - The total amount of itemized deductions is reduced by 3% of the amount by which the taxpayer's AGI exceeds the threshold amount, with the reduction not to exceed 80% of the otherwise allowable itemized deductions.

  Not all itemized deductions are subject to phaseout. The following deductions are not subject to the phaseout:

  o Medical and dental expenses
  o Investment interest expenses
  o Casualty and theft losses from personal-use property
  o Casualty and theft losses from income-producing property
  o Gambling losses

  Thus, a taxpayer who is subject to the full phaseout still gets to deduct 20% of the deductions subject to the phaseout and 100% of the deductions listed above.

Example: *Ralph and Louise from the previous example, who had an AGI of $426,300 for 2017, exceed the threshold for a married couple by $112,500. Thus, they must reduce their itemized deductions subject to the phaseout by $3,375 (3% of $112,500), but the reduction must not exceed 80% of the deductions subject to the phaseout. For 2017, Ralph and Louise had the following itemized deductions:*

	Subject to Phaseout	Not Subject to Phaseout
Home Mortgage Interest	$10,000	
Taxes	$8,000	
Charitable Contributions	$6,000	
Casualty Loss		$12,000
TOTAL	**$24,000**	**$12,000**

The phaseout is the lesser of $3,375 or $19,200 (80% of $24,000). Thus Ralph and Louise's itemized deductions for 2017 will be $32,625 ($24,000 - $3,375 + $12,000). Assuming Ralph and Louise are in the 33% federal tax bracket, the phaseout will cost them an additional $1,114 ($3,375 × 33%) of tax.

Conventional thinking is to maximize deductions. However, where taxpayers normally are not subject to a phaseout and have a high-income year because of unusual income, it may be appropriate, where possible, to defer paying deductible expenses to the year following the high-income year or perhaps pay and deduct the expenses in the preceding year if the out-of-the-ordinary additional income is planned for in advance.

If you have questions about how these phaseouts will impact your specific situation, you want to adjust your withholding or estimated taxes, or you want to make a tax planning appointment, please give this office a call.

Tips for Holiday Charity Giving

Article Highlights:

- Holiday Season Charity Gifts
- Long-form Itemization Required
- Documentation for Taxes
- Monetary Donations
- Property Donations
- Charity Scams
- Qualified Charities Only
- Disaster Scams
- ID Thieves

The holiday season is the favorite time of the year for charities to solicit donations. It is also the time of year when scammers show up in force, pretending to be legitimate charities in hopes of swindling you. It is also a festive and very busy time of the year, and you may inadvertently overlook the documentation needed to verify your generosity for tax purposes. Here are some tips for charitable giving.

Documentation – To claim a charitable deduction, you must itemize your deductions; if you don't, there is no need to keep any records of your donations. There are two types of charitable gifts: monetary and property.

Monetary donations include those made by cash, check, credit card, or other means. This type of contribution is only deductible if the donor maintains a record of the contribution in the form of either a bank record (such as a cancelled check) or a written communication from the charity (such as a receipt or a letter) showing the name of the charity, the date of the contribution, and the amount of the contribution. In addition, if the contribution is $250 or more, the donor must also get an acknowledgment from the charity for each deductible donation. Keep in mind that dropping cash in a holiday donation kettle without any documentation is not deductible.

Non-cash holiday contributions to organizations such as Toys for Tots and to seasonal food drives by recognized charities are also deductible. The deductible amount is the fair market value (FMV) of the items at the time of the donation, and you must document your donation with a detailed list of what was given and the name of the charity receiving the gift. Where the FMV of your gifts is $250 or more, you must also obtain an acknowledgment from the charity for each deductible donation. When gifts of property are $500 or more, there are additional record keeping requirements, so please call for details if you plan to make gifts of this value.

Watch Out for Charity Scams – To avoid scammers getting your charitable donations, make sure you are contributing to a legitimate charity and not to a bunch of crooks who work overtime during the holidays to trick you out of money.

Be wary of charities with names that are similar to familiar or nationally known organizations. Some phony charities use names or websites that sound or look like those of respected, legitimate organizations.

When in doubt, you should take a few extra minutes to ensure your gifts are going to legitimate charities. IRS.gov has a search feature—Exempt Organizations Select Check—that allows you to find legitimate, qualified charities to which donations may be tax deductible.

Disaster Scams – In the wake of significant natural disasters, such as Hurricane Matthew, it's common for scam artists to impersonate charities to get money or private information from well-intentioned taxpayers. Scam artists use a variety of tactics including contacting people by telephone or email to solicit money or financial information, and they may even set up phony websites that claim to solicit funds on behalf of disaster victims.

Watch Out for ID Thieves – Don't give out personal financial information such as your Social Security number or passwords to anyone who solicits a contribution from you. Scam artists may use this information to steal your identity and money. Using a credit card to make legitimate donations is quite common, but please be very careful when you are speaking with someone who called you; don't give out your credit card number unless you are certain the caller represents a legal charity.

Don't be a victim; make sure you are donating to recognized charities. Deductions to charities that are not legitimate are not tax deductible. If you have questions, please give this office a call.

Accounting 101: How to Read an Income Statement

Your income statement is one of the most important documents your company produces. However, if you are the owner of a new business, or if you aren't familiar with this type of statement, preparing and interpreting it can be challenging. To read your income statement accurately, consult the information below.

What is an Income Statement?

An income statement, which may also be referred to as a "profit and loss statement," is an important financial report that communicates your business's ability to earn a profit. This statement includes information about the money that came into your company during a given period, the expenses your company incurred during that period, and the total amount of profit you earned after all expenses were paid. If your expenses during this time exceeded the amount of income you earned, your income statement will show a loss for the period.

Sections of an Income Statement

In most cases, your income statement will be divided into various sections, including Revenue, Operating Expenses and Taxes. Within each section, smaller subsections exist to provide more detailed information. The final line on the statement provides your net profit or loss, which is calculated as the difference between your revenue and all of the expenses paid to earn that revenue.

Not every income statement includes the same information. However, most statements will include the following lines:

- **Heading** – At the top of the statement, you will find a heading that provides the name of your company and the period of time the statement covers.

- **Revenue** – The "Revenue" subheading begins the section of the statement that provides details about revenue earned during the period.

- **Gross Sales** – This line of the statement tells you the value of all sales made during the period before any deductions for expenses.

- **Returns and Allowances** – Returns and Allowances include the cost of any goods returned by customers or discounted by your company.

- **Net Sales** – Net Sales is calculated by subtracting the value of Returns and Allowances from your Gross Sales.

- **Cost of Goods Sold** – This line lists the total wholesale cost of all of the goods you sold during the period.

- **Gross Profit** – Gross Profit is calculated by deducting the Cost of Goods Sold from Net Sales.

- **Operating Expenses** – The Operating Expenses subheading begins the section of the income statement that includes all of the expenses your company paid to operate during the period in question.

- **Sales and Marketing** – Beneath the Operating Expenses subheading, you will find a smaller subheading labeled "Sales and Marketing." In this section, you will find a list of all of the expenses your company incurred in relation to marketing. Examples include advertising, commissions and direct marketing. At the bottom of this section, you will find a total of these expenses.

- **General Administrative** – This section of the document includes all of the administrative expenses paid during the period, including office supplies, utilities and more. At the end of this section, all general administrative expenses are totaled.

- **Depreciation and Amortization** – Under this heading, any expensive assets your business is currently depreciating will be listed, along with the total amount of depreciation for the period.

- **Total Operating Expenses** – This section of the income statement provides the total of your operating expenses for the period, including depreciation, administrative expenses and advertising expenses.

- **Operating Income** – Your Operating Income is the amount of income left over after all of your operating expenses are deducted from your gross profit.

- **Nonoperating Income** – This section includes all of the income you earned outside of your standard operations, such as by the sale of assets or investments.

- **Nonoperating Expenses** – Nonoperating expenses include expenses you paid that were not related to the operations of your business. These expenses may be related to earning nonoperating income.

- **Income before Taxes** – The value on this line is calculated by adding your Operating Income and Nonoperating Income and then subtracting your Nonoperating Expenses.

- **Taxes** – This section includes all of the taxes your business paid during the period, including prepaid income tax and payroll taxes.

- **Total Net Income** – The final line on your income statement is your total net income. It is calculated by subtracting your total Taxes from Income before Taxes. If your expenses for the period exceeded your income, this value will be negative, representing an overall loss.

In some cases, an income statement will have more than one column so that you can compare income and expenses from different periods.

Getting Professional Help

Preparing an income statement is no easy task, and interpreting it can also be taxing for many business owners. However, you can dramatically simplify this process by allowing an accounting professional to help you with your income statement and the other financial reports your business produces. A reputable accounting professional will not only ensure that your income statement is accurate, but the professional will also be able to help you gain important insight from these statements that can be used to boost your business's profitability in the future.