September 2016

Volume 9, Issue 1

Leslie A. Cesario, Ltd. Monthly Newsletter

Back to School? Tax Breaks May Help to Pay the Cost!

Article Highlights:

- Education Credits
- American Opportunity Tax Credit
- Lifetime Learning Credit
- Qualified Expenses
- Qualified Educational Institutions
- 1098-T

Now that summer is over, it is time for many young adults to head back to college or university, and it is time for their parents or family members to dig into their pockets to help pay for that schooling.

Paying for education can be financially challenging for many families. However, tuition and related expenses paid for higher education can qualify for one of two tax credits, which will lower the income tax burden for the individual who claims the exemption for the student. For example, if the student were claimed as a dependent on the parents' return, the parents would claim the credit, but if the student filed independently, he or she would get the credit. This is true regardless of who actually pays the tuition and related expenses.

American Opportunity Tax Credit (AOTC) – The AOTC provides a credit of up to $2,500 per year per eligible student. Generally, tax credits are non-refundable, meaning they can only be used to offset any tax liability the taxpayer may have for the year. However, up to 40% of the AOTC is refundable, even when the taxpayer has no tax liability. Thus, it can result in a refund of as much as $1,000 (40% of $2,500).

The credit is for 100% of the first $2,000 of tuition and related expenses and 25% of the next $2,000 of qualifying expenses. However, the AOTC is only allowed for four years of post-secondary education. It is also determined on a per student basis and phases out for higher-income taxpayers. The student must be enrolled at least half-time in a program leading to a degree, certificate, or other recognized educational credential for at least one academic period beginning in the tax year of the credit.

Lifetime Learning Credit (LLC) – The LLC is a non-refundable credit worth up to $2,000 per year, and there is no limit on the number of years that the LLC can be claimed. Unlike the AOTC, there is no "half-time student" requirement, and single courses can qualify. The credit is 20% of the cost of tuition and related expenses. However, while the AOTC is determined on a per student basis, the LLC is based upon the tax family's qualified education expenses for the year. Where a student qualifies for the more beneficial AOTC, that student's expenses cannot be used for the LLC.

There are additional requirements that apply to both credits:

- *Qualified expenses* – Qualified expenses include the costs you pay for tuition, fees, and other related expenses for an eligible student to enroll at or attend an eligible educational institution.

- *Eligible educational institutions* – Eligible institutions generally include any accredited public, nonprofit, or proprietary post-secondary institution eligible to participate in the student aid programs administered by the Department of

Education. This includes most colleges and universities. Vocational schools or other post-secondary schools may also qualify. If you aren't sure if the student's school is eligible, ask the school if it is an eligible educational institution.

- *Form 1098-T* – In most cases, you (or the student) should receive Form 1098-T, Tuition Statement, from the school reporting the qualifying expenses to the IRS and to you. The amount shown on the form may be either (1) the amount you paid to the school for qualifying tuition and related expenses, or (2) the amount billed by the school for qualifying tuition and related expenses. Therefore, the amount shown on the form may be different from the amount eligible for the credit. Don't forget that you can only claim an education credit for the qualifying tuition and related expenses that you paid in the tax year and not just the amount the school billed. There is a provision that allows the tuition for the first three months of the next year to be prepaid and deducted on the tax return for the year of payment. However, prepaid tuition cannot be deducted in the subsequent year.

There are other education tax benefits available as well, such as the education loan interest deduction and savings bond interest exclusion. If you are reading this article so you can plan for the future, there are also tax-advantage education savings plans available – the Coverdell and Sec 529 plans.

If you would like to learn how the education credits or other tax benefits might apply to your particular circumstances, please give this office a call.

Find Your Unclaimed Money

Each year literally billions of dollars go unclaimed from federal and state governments, financial institutions and companies no longer generating activity. These can include tax refunds, savings or checking accounts, stocks, uncashed dividends or payroll checks, traveler's checks, trust distributions, unredeemed money orders or gift certificates (in some states), insurance payments or refunds and life insurance policies, annuities, certificates of deposit, customer overpayments, utility security deposits, mineral royalty payments, and contents of safe deposit boxes.

- Currently, states, federal agencies and other organizations collectively hold more than $50 billion in unclaimed cash and benefits. CNNMoney

- About $2 billion in lottery prizes go unclaimed every year. CNNMoney January 12, 2016

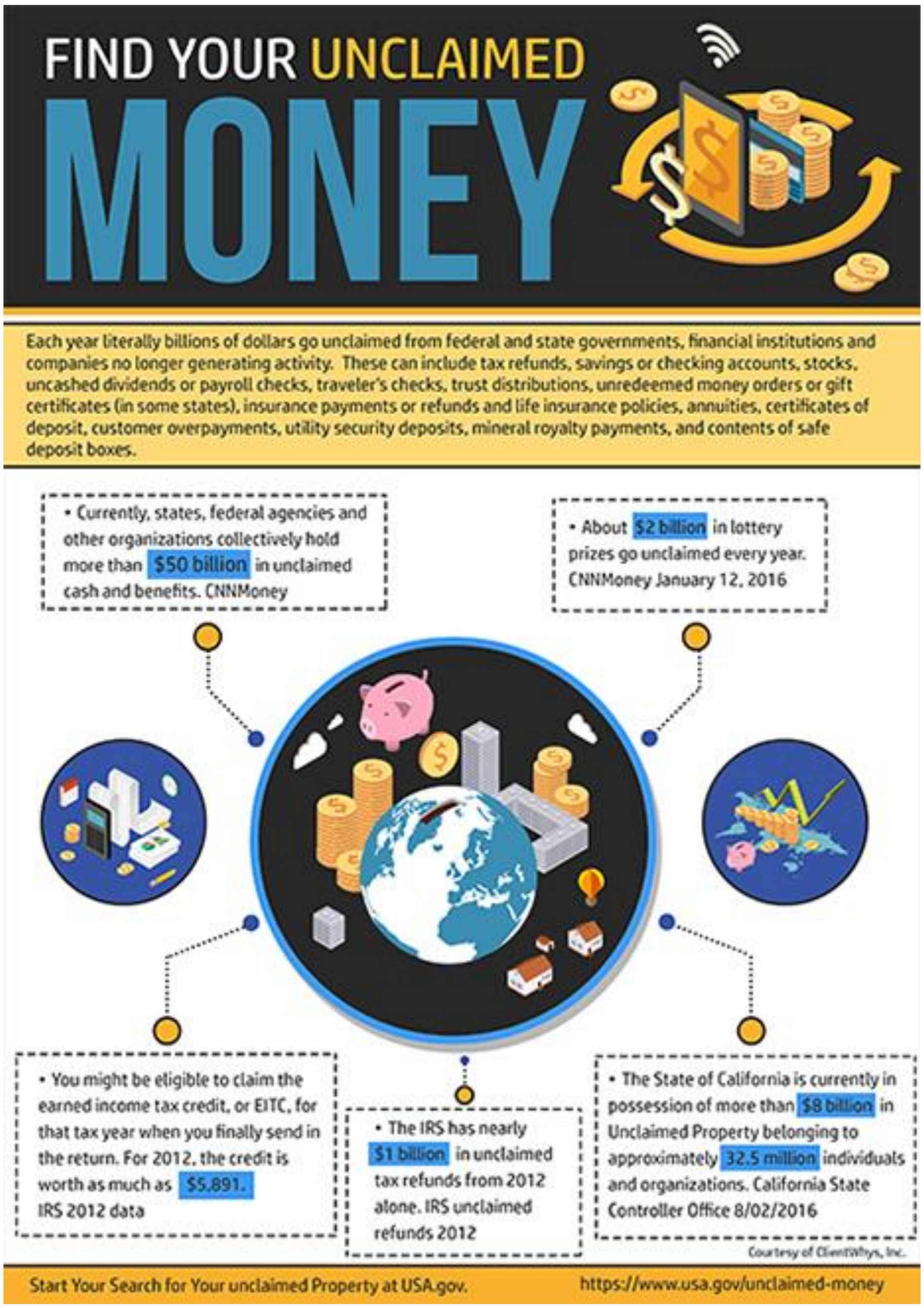
- The IRS has nearly $1 billion in unclaimed tax refunds from 2012 alone. IRS unclaimed refunds 2012

- You might be eligible to claim the earned income tax credit, or EITC, for that tax year when you finally send in the return. For 2012, the credit is worth as much as $5,891. IRS 2012 data

- The State of California is currently in possession of more than $8 billion in Unclaimed Property belonging to approximately 32.5 million individuals and organizations. California State Controller Office 8/02/2016

Start Your Search for Your Unclaimed Property at USA.gov.

(Click the link to increase size)
http://images.client-sites.com/Unclaimedmoney2.jpg



Is the HERO Solar Financing Solution Really a Hero?

Article Highlights:

- HERO Program
- Payments Included in Property Tax Payments
- Payments Are Not Deductible Property Tax Payments
- Deducting HERO Interest Payments
- Energy Credits

The Home Energy Renovation Opportunity (HERO) Plan is a program that finances the purchase and installation of eligible energy-efficient and water-saving upgrades in a taxpayer's home. These upgrades include solar panels, air conditioning, roofing, windows, lighting controls, and landscape-related products.

The HERO program originated in Riverside County in Southern California, the purpose being to provide financing for high-cost energy-related improvements for a taxpayer's home, such as solar panels, with principal and interest payments added to the taxpayer's property tax bill for the year. The HERO program has since spread to almost all counties in CA, and even some areas outside of California. You can also find ads for this program popping up frequently on the Internet.

The fact that the loan payments are included with the property tax payments has led to considerable misunderstanding, with many real estate agents and others claiming the entire payment is tax deductible, which is not true. Although included in the tax bill, the HERO payments are separately stated and not deductible as property tax.

However, the portion of the HERO payment that represents interest is generally deductible as home mortgage interest. Although the interest portion is not spelled out on the property tax bill, the HERO program does supply each borrower with a loan amortization schedule that allows the homeowner to determine the amount of interest paid for the year and the amount that may be deductible. Another issue is that the IRS requires lenders to issue Form 1098, which shows the amount of interest paid by the homeowner each year. The IRS uses that information to match the amount of interest deducted by the homeowner, and mismatches will result in an IRS inquiry. With the HERO program no 1098 is issued, and care must be taken with regard to how the interest is deducted on the tax return to avoid receiving a letter from the IRS. This problem has been so prevalent that the IRS Chief Counsel's Office issued an advice letter, and most recently the California Franchise Tax Board offered guidance on the issue.

The HERO program has very liberal qualifications, with no money down, fixed rates and variable terms between 5 and 20 years. However, compared to today's interest rates, those charged by the HERO program are quite high, generally in excess of 8%, and individuals should explore other avenues of financing first.

Although many of these energy-related improvements will qualify for tax credits, these credits are not refundable, which means they will only reduce your tax liability to zero, and the excess can be carried forward to future years as long as the credit is still in existence. The most substantial federal credit available is the popular solar credit of 30% of the cost of a solar installation, with no cap on the credit.

> ***Example:*** *If you install a $25,000 solar system on your home, the federal credit would be $7,500. However, if your tax liability for the year is only $1,500, you will only be able to use $1,500 of the credit, and the balance carries forward to a future a year.*

The solar credit percentage remains at 30% through 2019, and then gets lower each year until the credit ends in 2021.

If you are considering making energy-related home improvements and would like to discuss the tax benefits and your financing options, please give this office a call.

Partners May Not Be Employees

Article Highlights:

- Partner Employee Issue
- Self-employment Tax
- Employee Benefit Plans

If your partnership has been treating you and other partners as employees of a disregarded entity owned by the partnership in order for the partners to participate in employee benefit plans and receive other employee benefits, you'd better read this. Temporary tax regulations[(1)] recently issued by the IRS take aim at this practice and were written to put a stop to it.

Background: A disregarded entity is treated as a corporation[(2)] for the purposes of employment taxes. Therefore, the disregarded entity, rather than the owner, is considered to be the employer of the entity's employees for the purposes of employment taxes. However, the owner is not treated as an employee and instead pays self-employment tax on the net earnings from self-employment resulting from the disregarded entity's activities.

The current regulations do not include an example where the disregarded entity is owned by a partnership, and because of that some taxpayers have interpreted the regulations in a way unintended by the IRS. Under this incorrect interpretation of the regulations, some partnerships have permitted partners to participate in certain tax-favored employee benefit plans, which is contrary to the IRS's intention.

The IRS and the Treasury have noted that regulations did not create a distinction between a disregarded entity owned by an individual (a sole proprietorship) and a disregarded entity owned by a partnership in the application of the self-employment tax rule. In addition, the IRS does not believe that the regulations alter the long- standing holding[(3)] that:

(1) A bona fide member of a partnership is not an employee of the partnership, and
(2) A partner who devotes time and energy to conducting the partnership's trade or business, or who provides services to the partnership as an independent contractor, is considered self-employed and is not an employee.

To resolve this issue, the IRS has issued temporary regulations modifying the original regulations to clarify the rule that an entity disregarded for self-employment tax purposes applies to partners in the same way that it applies to a sole proprietor owner. Accordingly, the partners are subject to the same self-employment tax rules as partners in a partnership that does not own a disregarded entity.

The IRS is allowing any plan sponsored by an entity that is disregarded as an entity separate from its owner to apply the revisions on Aug. 1, 2016, or the first day of the latest-starting plan year following May 4, 2016, whichever is later.

If this issue affects you, your partnership, and a disregarded entity owned by the partnership and you have questions, please give this office a call.

(1) Reg. Sec. 301.7701-2T
(2) Reg. Sec. 301.7701-2(c)(2)(iv)(B)

(3) Rev. Rul. 69-184

Surprised by the Alternative Minimum Tax?

Article Highlights:

- How the AMT is Determined
- Medical Deductions
- Deduction for Taxes Paid
- Home Mortgage Interest
- Miscellaneous Itemized Deductions
- Personal Exemptions
- Standard Deduction
- Incentive Stock Options
- Business Incentives

When looking over your tax return, do you notice an amount on line 45? If an amount is entered there, it is because you are subject to the alternative minimum tax (AMT). The AMT is a generally punitive method of computing income tax that does not allow some of the tax preferences and deductions that regular tax computation allows. When an AMT computation results in a higher tax, the higher tax applies, and the additional tax from the AMT is added on line 45 of your return.

The AMT was originally designed (nearly 50 years ago) to impose a minimum tax on higher-income taxpayers who were avoiding taxes by claiming certain (legal) deductions or other tax benefits (also termed "preferences"). However, years of inflation have caused an increasing number of taxpayers to be subject to the AMT.

It is complicated to determine when an individual will be subject to the AMT, for many tax preferences can trigger the AMT, alone or in combination. The following are some of the items that frequently trigger the AMT for the average taxpayer:

- **Medical Deductions** – Deductions for medical expenses are allowed for the AMT computation – but only to the extent that they exceed 10% of the taxpayer's income. Although the limit is also 10% for regular tax purposes, through 2016, taxpayers age 65 and over enjoy a lower limit of 7.5%, which leads to an AMT adjustment. Sometimes, it is possible to defer or accelerate medical expenses from one year to another (for example, by paying an orthodontist in installments or all at once). If your employer offers a flexible spending plan, consider participating, as such plans allow you to pay medical expenses with pretax dollars while avoiding both regular and AMT deduction limitations.

- **Deduction for Taxes Paid** – When itemizing deductions, a taxpayer is allowed to deduct a variety of other taxes, such as real or personal property taxes and state income or sales taxes. However, for AMT purposes, none of these itemized taxes is deductible. For most taxpayers, this represents one of the largest tax deductions, and it frequently triggers the AMT. If you are affected by the AMT, conventional wisdom dictates deferring tax payments to a subsequent year when the AMT may not apply. When deferring, care should be exercised regarding late-payment penalties and interest on underpayments. In addition, taxpayers can annually elect to capitalize their taxes on unimproved and unproductive real estate. This means foregoing the deduction and adding the tax paid to the cost basis of the real property.

- **Home Mortgage Interest** – For both regular tax and AMT computations, interest paid on a debt to acquire or substantially improve a first or second home is deductible as long as it does not exceed the debt limit (generally $1 million). This is also true of refinanced debt, except that any increase in debt is treated as equity debt. For regular tax purposes, the interest on up to $100,000 of equity debt on the first two homes can also be deducted. However, equity debt is not deductible when computing the AMT; neither is acquisition or equity debt on a motor home or boat that may qualify as a second home. Therefore, taxpayers should exercise caution when incurring home equity debt. Generally, loan brokers are not aware of these limitations, and there are numerous pitfalls.

- **Miscellaneous Itemized Deductions** – Among miscellaneous deductions, the category that includes employee business and investment expenses is not deductible for AMT purposes. For certain taxpayers with deductible employee business expenses, this will often trigger the AMT. Employees with significant employee business expenses should attempt to negotiate an "accountable" reimbursement plan with their employers. Under this type of plan, reimbursement for qualified expenses is tax-free. An employee who has been reimbursed no longer claims a deduction for those expenses, thus eliminating the miscellaneous deduction. Another strategy would be to defer the expenses to a year that is not affected by the AMT.
- **Personal Exemptions** – The AMT computation does not allow a deduction for personal exemptions, which in 2016 is $4,050 each for the taxpayer, his or her spouse (if any) and any dependents. Divorced or separated parents should carefully consider which party should claim the exemption for their children if one of the parents is subject to the AMT.
- **Standard Deduction** – For regular tax purposes, taxpayers have the option of itemizing their deductions or taking the standard deduction. However, for AMT purposes, there is no standard deduction. Thus, a taxpayer who ends up with an AMT when taking the standard deduction should try to force itemized deductions, even if the result is less than the standard deduction. The result will be an increased regular tax but a reduced AMT, which could result in overall tax savings. Even the smallest of deductions will benefit those who are taxed at a minimum of 26% (the lowest bracket for the AMT).
- **Incentive Stock Options** – Although not frequently encountered, incentive stock options (ISOs) can have a profound impact on a taxpayer's AMT. Generally, to achieve the beneficial long-term capital gains rates on stock acquired through an ISO, a taxpayer must hold the stock for more than one year after exercising the stock option and two years after the option is granted. However, the difference between the fair market value and the option price must be added to the taxpayer's AMT income in the year the option is exercised. To avoid this substantial AMT preference income, the taxpayer can sell the stock in the year that the option is exercised and forego long-term capital gains rates. Alternatively, when doing so is beneficial, the taxpayer can exercise the option in small blocks over a period of years.
- **Business Incentives** – Taxpayers' investments in businesses and partnerships sometimes provide tax incentives that the AMT does not allow. There is a long list of these incentives, but the most common are depletion allowances and intangible drill costs. Generally, these items appear on a Schedule K-1 (which the business activity issues to the investor) and are then included in the taxpayer's AMT calculation.

As you can see, the AMT can be an extremely complicated area of tax law. Careful planning is required to minimize its effects. Please contact our office for further assistance.

Don't Miss out on the Electric Vehicle Credit

Article Highlights:

- How the Credit Amount Is Determined
- Manufacturer Phaseouts
- Credit for Specific Vehicles
- Allocation between Business and Personal Use
- Non-refundable Limitations

If you are considering purchasing a new car or light truck (less than 14,000 pounds), maybe you should consider one of the many electric vehicles currently being offered for sale and take advantage of a federal income tax credit worth as much as $7,500.

The tax credit is actually made up of two parts: the basic amount of $2,500, which requires the electric vehicle to have a battery with at least 5 kilowatt-hours of capacity, and an additional $417 of credit for each kilowatt-hour of battery capacity in excess of 5 kilowatt-hours. The total amount of the credit allowed for any qualified vehicle is limited to $7,500.

However, the credit begins to be phased out for a particular manufacturer's vehicles when at least 200,000 qualifying vehicles have been sold for use in the United States.

If you are not an electrical engineer, it may seem a little complicated to figure out which vehicles qualify for the credit and for how much. You can usually rely on the information provided by the dealer. However, to be on the safe side, you can verify which vehicles are qualified and the credit amount available, based on the vehicle's kilowatt-hours and the reduction in credit due to the credit phaseout, by visiting the IRS website From the list on the linked page, click on the manufacturer of the vehicle you are interested in to find out if the model and year of that vehicle qualify for the credit and the amount of the credit.

To be eligible for the credit, you must acquire the vehicle for use or lease and not for resale. Additionally, the original use of the vehicle must commence with you, and you must use the vehicle predominantly in the United States. The vehicle is not considered acquired prior to the time when its title passes to you under your state's law. The credit is available whether you use the vehicle for business, personally or a combination of both. The prorated portion of the credit that applies to business use becomes part of the general business credit, and any amount not used on your return for the year when you purchase the vehicle can be carried back to the previous year and then carried forward until used up, but for no more than 20 years.

What a Dealer May Not Tell You – The portion of the credit that is not treated as a general business credit (i.e., the personal use portion of the credit) is non-refundable. That means it can only be used to offset your tax liability for the year when you purchase the vehicle, and any excess credit is lost. Assuming you purchase the vehicle in 2016 and your 2016 tax return will be similar to your 2015 return, you can get an idea of how the credit will apply to you by comparing the amount on line 47 of your 2015 Form 1040 to the credit the vehicle provides. If line 47 is greater than the credit, then you will probably benefit from the entire amount of the credit on your 2016 return. If it is less, then you will only benefit from the amount on line 47 as it will be figured for your 2016 return.

If your 2016 tax return will be significantly different from your 2015 return, or you simply want to verify your benefit from the credit, please give this office a call.

New Business? First-Year Deduction Strategies

Article Highlights:

- Equipment Depreciation & Expensing Opportunities
- Vehicle Luxury Auto Rules
- Leasehold Improvement Expense Options
- Start-Up Cost Elections
- Organizational Expense Alternatives

If you are planning a new business start-up and are incurring some expenses, you probably anticipate deducting those expenses in the first year of the business's operation. Unfortunately it is a little more complicated than that. Expenses a business incurs in the beginning can include equipment purchases, vehicle purchases and use, leasehold improvements, organizational costs and start-up expenses, and each receives a different tax treatment.

- **Equipment** – The equipment you buy can't be deducted until it is placed in service. For that reason, you can't make any equipment deductions until the business is actually functioning. However, deductions for most equipment purchases are very liberal. For most small businesses, this means the entire cost of equipment and office furnishings can generally be written off in the year of purchase, if that is also the year when the equipment is put into service, using the Sec 179 expensing election. However, the deductible amount is limited to taxable income from all the taxpayer's active trades or businesses (including a spouse's active trades or businesses if married and filing jointly). Income from trades also includes W-2 income.

  Sometimes it may not be appropriate to write off the entire cost in the first year, in which case the equipment can be depreciated over its useful life (according to recovery periods established by the IRS). Most office furniture, fixtures and equipment are assigned a 7 year recovery period, but the depreciable period for computers is 5 years. The recovery period of equipment may vary depending on the type of business activity. There is also a 50% bonus depreciation election for the first year the equipment is placed in service.

- **Vehicles** – Automobiles and small trucks that are purchased for use by the business are treated like equipment, as above, except their recovery period is 5 years and they are subject to the so-called luxury auto rules. These rules limit the depreciation to a maximum of $3,160 ($3,560 for light trucks and vans) for the first year. If bonus depreciation is elected, add $8,000 to the first-year maximum.

- **Leasehold Improvements** – Generally, leasehold improvements are depreciated over 15 years. But through 2019, bonus depreciation may be elected, allowing between 30% and 50% of the cost of interior qualified improvements to non-residential property after the building is placed in service to be deducted in the first year. In addition, the Sec 179 expense deduction is allowed for qualified leasehold property, qualified restaurant property and qualified retail improvements.

- **Start-Up Costs** – Taxpayers can elect to deduct up to $5,000 of start-up costs in the first year of a business. However, the $5,000 amount is reduced by the amount of the start-up costs in excess of $50,000. If the election is made, the start-up costs over and above the first-year deductible amount are amortized over 15 years. If the election is not made, the start-up costs must be capitalized, meaning the expenses can only be recovered upon the termination or disposition of the business. Start-up costs include:
  - Surveys/analyses of potential markets, labor supply, products, transportation, facilities, etc.;

    - Wages paid to employees, and their instructors, while they are being trained;
    - Advertisements related to opening the business;
    - Fees and salaries paid to consultants or others for professional services; and
    - Travel and related costs to secure prospective customers, distributors and suppliers.

- **Organizational Expenses** – If the new business involves a partnership or corporation, the business can elect to deduct up to $5,000 of organization expenses in the first year of a business. This is in addition to the election for start-up expenses. Like start-up expenses, the $5,000 amount is reduced by the amount of the start-up costs in excess of $50,000. If the election is made, the start-up costs over and above the first-year deductible amount are amortized over 15 years. If the election is not made, the start-up costs must be capitalized. Organizational expenses include outlays for legal services, incorporation fees, temporary directors' fees and organizational meeting costs, etc.

The foregoing is an overview of some of the expense issues in a business's first year. As you can see, major decisions and elections need to be made that can have a lasting impact on the new business. You are encouraged to consult with this office for additional details and assistance in preparing a tax plan for your planned new business.

Should Our Olympic Champs Be Taxed On Their Prize Money & Medals?

Article Highlights:

- Olympian Prize Money
- Gold Medals Aren't Solid Gold
- Legislation to Exempt Prize Money and Medals from Taxation

You may not realize this, but in addition to winning an Olympic medal, winners are compensated by the U.S. Olympic Committee with prize money: $25,000 for a gold medal, $15,000 for a silver medal and $10,000 for a bronze medal.

Oh, and by the way, the gold medals are not solid gold. In fact, they haven't been solid gold since the 1912 Stockholm Games. This year's gold medals are 92.5% silver with 24k gold plating. The 2016 Summer Olympics medals are worth roughly $587 in precious metals; however, they can bring many times that in an auction.

According to Sen. Charles Schumer, D-NY, both the prize money and the value of the medals are taxable income to our athletes. Schumer and Sen. John Thune, R-SD, have sponsored legislation exempting the value of medals and prizes awarded to Olympic and Paralympic athletes. The Senate has already passed the bill, but it has not been taken up by the House yet.

Gone (for 30 years now) are the days of Olympic participants being amateurs only. Some oppose exempting U.S. Olympians from being taxed on their awards for a couple of reasons: (1) recipients of other prizes, such as the Oscar swag bags, are required to pay tax on the value of their prizes, so why should Olympic athletes be treated differently? and (2) professional athletes who participate in sports as a business (NBA players, PGA golfers, etc.) can deduct their training and travel expenses as business expenses, and those who participate as a hobby may also be allowed some limited deductions. So is it necessary to exempt the Olympians' winnings?

Congress is in summer recess and will not reconvene until after the games are completed. So we'll have to wait for the results post-games.