TAX NEWS

Compliments of:
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Summer 2015 TAX CLIENT NEWSLETTER

Dear Client:

We are now half way through 2015 and it has only been a few months since we filed your 2014 return but now is really the time to begin getting ready for the next return.

Never to Early to Start Thinking About Filing the Next Tax Return

Proper planning is important and positioning yourself to pay the smallest possible tax is an ongoing process. If you owed money on your 2014 return then we should be discussing what caused the shortage. If your withholding wasn't sufficient on your salary, IRA, pension or social security distributions then we should get together to structure how the shortage can be eliminated or minimized for **2015.**

Because our U.S. tax system is based on a marginal bracket structure and dependent on filing status the last dollars included in your gross income can be taxed at a much higher rate than your effective tax rate. When you have federal income tax withheld, the amount is based on the number of exemptions you provided to your employer when you filled out your W-4 form or the dollar amount or percentage of the distribution submitted to the IRA or pension plan administrator. Maybe the number of exemptions that you claimed were too many. The more exemptions you claim on Form W-4 *lessens* the federal tax withheld which gives you a smaller tax credit against the total tax liability. The other item to keep in mind is that your withholding with your employer assumes that this is the **only** source of income that you have for tax filing purposes. In addition, when both spouses have W-2 income the other employer's withholding isn't designed to take that into account. If you have other sources includible in your gross income such as interest, dividends, capital gains, gambling winnings, prize winnings, rental income, self-employment income, etc., then you could be underpaid when it comes time to file your 2015 tax return in April 2016. If you are receiving IRA distributions, pension distributions and/or social security benefits and do not have any federal income tax withheld or have less than your marginal bracket withheld then you may be cutting a check when you file that return and that check could include a penalty for the underpayment of estimated taxes.

In order to avoid the payment of a penalty for under withholding the law requires that taxpayers pay in a minimum amount of tax in the form of withholding and/or estimated payments by January 15 of the year following the close of the tax year. For the 2015 tax year this is January 15, 2016. The rule provides that in order for the taxpayer to avoid any penalty they must pay in the *lesser of* **100%** of the *prior year* tax (2014 tax) or **90%** of the current year tax (2015 tax).

As an example, if your total tax liability in 2014 was **$10,000**, then you must have $10,000 paid in via withholding and/or quarterly estimated payments. If your 2015 tax is going to be $12,000, then your estimated amount would be **$11,800** (90% - $12,000). As a result you would only be required to pay **$10,000** by January 15, 2016, but you are writing a check on April 15, 2016 for the $2,000 balance. If your 2015 tax is **$9,000,** then you would only be required to pay **$8,100** in the form of withholding and/or estimated taxes by January 15, 2016 and then still write a check for **$900** on April 15, 2016. Even if you are not subject to the penalty, you want to know how much you are short prior to the end of the year so that you can be ready to pay the balance when you file your return.

In order to do better planning on withholding and estimated payments and avoid penalty call me today to set up an appointment to discuss this and other important issues.

It's Time for You to Begin Discussing Your Tax and Financial Issues with Your Spouse

My years in practice has allowed me to witness certain family roles and responsibilities between spouses. In many cases I find that only one of the spouses has an understanding of the tax and financial issues. With the hectic busy lives that we live, it is difficult to grasp much of what is going on in our lives on a daily basis when it comes to money. The financial environment has changed dramatically. Payroll checks are directly deposited into a bank account; mortgage payments, car payments, utility bills, etc. are paid via electronic fund transfers. Food, clothing, gasoline, travel and entertainment are paid with credit cards and the credit cards are paid automatically out of the checking account on the due date each month whether it is a stated monthly amount or paid in full.

We have become a cashless society and when we do have cash we get it from an ATM and take it out in the form of $20 bills which disappear like raindrops. Many people do not reconcile their bank accounts and as a result they are not taking that important time to periodically review their financial lives and discuss that life with their spouse. Some individuals are frightened by financial and tax issues because they have never been taught about the importance of them or because they feel it is out of their realm of comprehension. Even worse, some individuals live in total denial of their financial responsibilities and the underlying consequences.

The reason I bring this up is that there are always *life changes* which will impact the need to know about your financial life. I have dealt with clients whose life was changed in a heartbeat because of the death, illness or divorce of a spouse and they had little or no idea about the money issues that they now needed to face. Some of them had not written a check in years, had no idea how much debt existed, did not know what assets they owned and how much money was in bank. Clients who are faced with the illness of a spouse also need to be aware of the finances, because now they also need to understand the health insurance coverage that is available, the deductibles that they must absorb, the amount of the co-pays, restrictions, etc. of the policy.

Many times the spouse who is "in-charge" of the finances is handicapping themselves, their spouse and their family when they do not take the time to get everything organized. Nothing is promised to anyone and everything is temporary and when a life change takes place you want to be ready for it the best you can. In order to get ready start with a 3 ring binder and fill it with the following information:

- List the names of your lawyer, accountant, financial planner, stockbroker, insurance agent and every other important outside party with whom you have financial ties. Make sure to include their contact data such as address, phone numbers, e-mail addresses, etc.
- Insert a copy of your will, living trust, insurance policies, including life, health, disability, umbrella policies, auto, homeowner's, etc.
- List all assets including bank accounts, brokerage accounts, ownership in any business, IRAs, pensions, social security benefit statements, homes, cars, boats, land, collectibles, etc. Include college savings plans that you have established for children, grandchildren, etc. If there are assets which are not in joint ownership you need to determine if there is a need to have the assets transferred to a joint account. You may even have to determine if jointly owned assets should be separated.
- List all debts including mortgages, lines of credit, credit cards, auto loans, school loans, business debts, etc. Make sure you list how these debts are paid and the dates they are due for payment as well as a priority list as to which debts should be paid before others in case of liquidity shortages.
- In some situations spouses may be planning on having the financial affairs turned over to a 3rd party such as a trusted individual who is skilled in financial issues, such as an adult child, other family member, close friend or a professional who is hired to take over the finances. In any case, the spouse should be made aware of the plan so that they are in the loop and know who to contact and who will be taking responsibility for their financial life. Informing the spouse about the skills and capabilities of these individuals or institutions is important.

If you would like to discuss these types of financial and tax issues contact me soon so that you can feel confident that the stress to you and your loved ones is reduced.

Sole Proprietors Should Consider Hiring Their Children

If you are operating your business as a sole proprietor then you have a great opportunity to reduce your federal income tax and self-employment tax. In most states you will also reduce the State income tax. As a sole proprietor you include a Schedule C with your Federal Form 1040 which reports the revenue and expenses of your business. The net profits from the Schedule C are included in your gross income and in your self-employment income on Schedule SE which is also part of your Form 1040. The income tax is assessed based on your marginal tax bracket and your self-employment tax is assessed at a rate of 15.3% on the first $118,500 in 2015 and at 2.9% on the amount above $118,500.

The law allows sole proprietors to hire their children as employees. For those children who have not reached age **18** the law does not require the **7.65%** withholding and **7.65%** matching of Social Security and Medicare Tax. As a result, this is a direct **15.3%** tax savings for the family unit. The child must provide a legitimate function to the operation of the business. The child must be issued a W-2 form which reports all the Federal wages for the year. In today's world these children are skilled in using computers and analyzing the use of software programs and time saving skills through the use of data entry, filing, etc.

In 2015 each taxpayer has a standard deduction amount of $6,300. If the child is under the age of 18 then the savings for self-employment tax is $963.90 (15.3% x $6,300). If the parent is in the 25% federal income tax bracket then it saves another $1,575 (25% x $6,300). This is a total tax savings of $2,538.90 per child. If the child is age 18 or older then the parent's marginal tax bracket of 25% saves income tax of $1,575 and the 15.3% is a trade-off between parent and child but the parent can deduct the 7.65% matching as a Schedule C expense instead of only a deduction for calculating adjusted gross income. In addition, as the Schedule C income decreases, the Adjusted Gross Income decreases and has an impact on provisions which phase out benefits such as:

- **§21** Dependent Care Credit
- **§24** Child tax credit
- **§25A** Educational tax credits
- **§36B** Premium Assistance Credit for Health Care Premiums
- **§67** Miscellaneous Itemized Deductions Subject to 2% of Adjusted Gross Income
- **§68** Phase-out of itemized deductions on Schedule A
- **§151** Phase-out of personal exemptions for the taxpayer and dependents
- **§219** Deductible IRA contributions
- **§219** Roth IRA contributions
- **§221** Student Loan Interest Deduction

- §222 Qualified Tuition and Fees Deduction
- **§469** The special passive activity loss on rental real estate for active participation
- **§530** Coverdell Education plan contributions
- Etc.

By reducing your Adjusted Gross Income you will also reduce the base for purposes of the Alternative Minimum Tax.

If you want to know more about the opportunities of hiring your children because you are a sole proprietor please contact me soon.

Teachers Contact Your Congressional Representative

There is a special deduction which was available for elementary and secondary education school teachers in 2014 which has **expired** and Congress may not consider extending until *after* 2015. The deduction is limited to **$250** and reduces your adjusted gross income which is important for many other tax provisions which may be available to you. This maximum **$250** deduction is reported on the front page of your tax return so you do not have to itemize your deductions in order to take advantage of this benefit.

If you have costs that you paid or incurred which are *greater than* **$250** then those excess expenditures can be deducted on **Schedule A** of your Form 1040 if you *elect* to itemize your deductions. In addition, those excess expenditures are subject to a **2%** of Adjusted Gross Income (AGI) limitation which means that you will only be able to actually deduct the amount *greater than* **2%** of your AGI. For instance if you spent $1,000 during 2014 you would have been able to deduct $250 on the front page of your return and the *excess* **$750** is limited. If your AGI is $35,000 then **2%** of $35,000 is $700 and you would absorb that *first* $700 and *only* the **$50** excess would be an allowable deduction.

The **$250** deduction was available for classroom supplies, books, computer equipment, software and any other supplementary materials used in the classroom. This deduction **expired** at the end of 2014. The deduction was also available for principals, librarians and other classroom assistants who are considered full-time workers. Call me for more details so that we can discuss this and any other questions that you may have.

Some Itemized Deductions on Schedule A Have Expired: Contact Your Representative in Congress

If you elect to itemize your allowable personal deduction items on **Schedule A** then there are a few deductions that have expired at the end of 2014. One item is the sales tax deduction for those taxpayers who do not pay any or pay little state income taxes. Therefore, based on Tables established by the IRS you may be able to deduct the sales taxes paid on your consumption of goods and services. In addition to the Standard Table amounts you can also deduct the sales tax paid or incurred on big ticket items such as automobiles, boats, building materials, etc. You will need to have your receipts in order to deduct and verify the sales tax deduction. Contact me for more information.

The other Schedule A itemized deduction that expired *after* 2014 is the deduction for Mortgage Insurance Premiums (**PMI**). If you have a mortgage and are paying **PMI** then you could be eligible for this deduction. The deduction does have a phase-out provision once your Adjusted Gross Income (AGI) reaches $100,000. It is completely phased out when your AGI reaches $110,000.

An Education Benefit Has Expired: Contact Your Congressional Representative

There is an education benefit that expired at the end of 2014 that we are waiting for Congress to extend for 2015 and beyond. The benefit is the deduction for "qualified higher education expenses" and it is available even if you do not itemize deductions on Schedule A. This benefit would be available for each qualifying student on the tax return. The deduction could be $2,000 based on your modified AGI or $4,000 if your modified AGI is *lower than* a specified threshold amount based again on your filing status. If your filing status is single or head of household and your income is **$65,000** or less then you could be eligible for a **$4,000** deduction. If your income is *greater than* **$65,000**, but is not greater than **$80,000** then you would be eligible for a **$2,000** deduction. Any amount *greater than* **$80,000** disqualifies you from the deduction. For a married couple filing a joint return the **$4,000** deduction is available if your income is *less than* **$130,000**. If it is *more than* **$130,000** but not *more than* **$160,000** then you would be eligible for the **$2,000** deduction. If you are married but file separately from your spouse then the deduction is not available to either of you.

Child Tax Credit

There is a Child Tax Credit available to qualified taxpayers who have a dependent child *under* the age of **17** at the close of 2014. The maximum credit is **$1,000**. The credit is available to a taxpayer based on their filing status and modified Adjusted Gross Income.

The credit is phased-out as income rises. For a single taxpayer with one qualifying child the phase-out begins at $75,000 and is completely gone at $94,001. It is the same range for those taxpayers with a filing status of Head of Household. For taxpayers filing a married joint return the phase-out for one qualifying child is between $110,000-$129,001 and for a filing status of married filing separately it is half of that of at $55,000-$74,001. Give me a call so we can discuss this important tax benefit in further detail.

Consider Making IRA Contributions

Contributions to an Individual Retirement Account (IRA) are a good way to save for your future. The **maximum** contribution for 2015 is **$5,500**. Anyone who has "earned income" such as wages, salary and self employment is eligible to make the IRA contribution. The taxpayer with a modified AGI below specified thresholds based on their filing status has the opportunity to deduct their contributions therefore paying less tax in the current year. Again the ability to deduct your IRA contribution is based on levels of income. For a married couple filing a joint return if your income is *less than* **$98,000** then you can deduct **$5,500** in full for both you and your spouse even if only one of you has earned income. Therefore with a minimum of $11,000 of total earned income you could deduct it in full. As your modified AGI increases up to $118,000 you begin to lose the ability to deduct the contribution. However, the excess amount can be contributed to a Roth IRA which is a nonductible contribution but the growth will never be included in your gross income when you take a future distribution.

If you are age 50 or older on the last day of the tax year then you can contribute an additional $1,000 for what is called the "catch up" contribution. This will increase your deduction to $6,500 and for a married couple filing a joint return the total amount would be $13,000.

For taxpayers whose filing status is single or head of household you are eligible for a **$5,500** deductible IRA when your modified AGI is **$61,000** or less. When you have an income *in excess of* **$71,000** you can no longer make a deductible IRA. Between $61,000 and $71,000 the $5,500 is phased out but again you should contact me about the benefits of a Roth IRA contribution.

There is a special rule only for married couples who file a joint return where one spouse either does not have any earned income or has earned income but is not eligible to participate in an employer's pension plan. If this is your situation then for 2015 you can have a **$5,500** deductible IRA contribution when your joint modified AGI is **$183,000** or less. The **$5,500** maximum deductible contribution decreases as your income grows *between* **$183,000** and **$193,000**. And again if you and/or your spouse is age **50** or older on the last day of the tax year then you can contribute an *additional* **$1,000** for each qualifying spouse for the "catch up" contribution.

If you want total tax-free growth in an IRA then let's discuss a contribution to a Roth IRA which is available to single taxpayers whose modified AGI is $116,000 or less with a phase-out up to $131,000. For married couples filing a joint return the threshold is between $183,000 and $193,000 of modified AGI.

Health Care Issues for 2015 and Beyond

In March of 2010 Congress passed health care legislation which has become known as the "Affordable Care Act" or ACA. For purposes of filing your **2015** tax returns and beyond you may be eligible for a new refundable credit called the "Premium Assistance Credit" (**PAC**). You are eligible if you have obtained your insurance coverage through the government's "market place" or American Health Benefits Exchange. Each state was required to establish an exchange no later than January 1, 2014. For those states that did not do so, there is a Federal Exchange through which insurance can be obtained. The credit is available if the insurance you obtained meets the requirements of "minimal essential coverage" as provided in the legislation. About 8 million individuals have acquired insurance coverage through the Exchanges and about 6.7 million are eligible for the premium assistance credit and you may be one of them. The credit is based on your modified adjusted gross income which will be determined when we prepare your 2015 federal income tax return in 2016. If you are eligible for the credit then you may have already benefitted by it in the form of an "advanced" **PAC** where the government has paid a portion of your monthly premiums directly to the insurance provider. In order to determine whether you will receive additional credit or have to give some of the credit back because your income actually increased over what was reported when you applied for the coverage, there will be a reconciliation calculation at the time we prepare your return.

Even if you are not eligible for the **Premium Assistance Credit** everyone is required to have health insurance coverage and there could be a penalty imposed for not having coverage. Even if you have coverage you will need to report that fact on your Form 1040 and are required to do extra reporting on your return as a result of the legislation. Your employer and/or insurance provider will be sending you a required government report which you will need to provide to us in order to properly prepare your return. You will receive an IRS **Form 1095-A** if you receive your insurance coverage though the government marketplace. If you have private insurance you will receive an IRS

Form 1095-B from your insurance company. If your employer has a health insurance plan you will receive an IRS **Form 1095-C** from your employer which informs you of the health insurance offer and the coverage received if any.

To understand more about the issues of health coverage contact me soon.