

TAX NEWS

Winter 2014

TAX CLIENT NEWSLETTER

Dear Client:

You are now getting to that point where your 2014 tax return issues need to be addressed and the following are some of the things that you should be thinking about:

Gathering and accounting for all sources of income: It is important for you to understand that the general rule is that everything received is counted as income *unless* the law provides for a specific exemption, exception, or exclusion. With that said, if you receive a “gift” from someone, then that is not includible in your gross income. Also, if you borrow money from someone then that isn’t income either. However, if you don’t pay the borrowed money back and the lender “forgives” that debt, then the “forgiveness of debt” is includible in your gross income. This becomes particularly important where the money exchanging hands is between related parties such as parents and children and sibling to sibling. In many situations the lending of money may start out as a loan but as time progresses the intent changes and the lender does not hold the borrower liable anymore and decides to just make the transfer a “gift”. However in other cases the transferor might decide to “write off” the loan and “forgive” the borrower which then causes the inclusion of income. If you find yourself in a situation like this then we need to discuss the issues in order to determine the proper reporting on your Form 1040.

On the flip side of this transaction the lender also needs to examine if there is any reporting responsibility on their end. If the lender transfers funds as a loan then they should reduce this trans-

fer to writing stating the amount borrowed, the terms of the repayment, such as interest rate and payback period of the loan, as well as the collateral for the loan. If the lender subsequently “forgives” the debt then the issue of a capital loss or ordinary bad debt will need to be reviewed. If it happens that the lender changes the transfer to a “gift” then the issues of filing a Gift Tax return Form 709 for Gift Tax reporting needs to be discussed. So make sure you let me know if you have had this type of transaction during 2014 so that it can be determined if you have any type of reporting responsibility to the IRS.

Birth of a Child: If you have a newborn this year then you could be eligible for up to a \$1,000 Child Tax Credit which is available for a child who qualifies as your dependent. The credit is really available for all qualifying children who haven’t turned age 17 by December 31, 2014. The allowance of the credit is based on your filing status and your modified adjusted gross income. For a single taxpayer with one child and income under \$75,000 the credit is fully allowed. The \$1,000 credit is reduced by \$50.00 for each \$1,000 or fraction thereof above \$75,000 and completely phased out at \$94,001. For a married couple filing a joint return the phase out range is from \$110,000 - \$129,001. If a married couple files separate returns then the phase out is from \$55,000 - \$74,001. Let’s discuss your situation soon.

Gathering Tax Documents: You will be receiving various official tax documents needed in order for us to properly prepare your tax return. You could be receiving the

following types of documents

- W-2 from wages from your employer(s)
- 1099-INT for interest income from banks, credit unions, brokerage firms, private investors, etc.
- 1099-DIV for dividends from your brokerage accounts where you invest
- 1099-G from a government agency such as a state refund for prior year(s) income tax refunds
- 1099-MISC for services provided to customers and clients. These amounts are generally subject to inclusion in your income for both income tax and self-employment tax. In some cases they may be reporting rental income, royalty income or miscellaneous sources such as a prize winning.
- W-2G is the document received from gambling winnings from a casino which will be reported under “Other Income”. Note that your losses, if any, are allowed as deductions but only to the extent of your winnings and only if you elect to itemize your deductions on Schedule A. Note that if you use the Standard Deduction based on your filing status your losses will not be allowed.
- 1099-B Broker Reporting Statements for Sales of Securities. If you invest with a brokerage house then they are required to provide you with a year-end report which requires the listing of each sale transaction showing the security sold with the selling price of the security. If the security was acquired *after* December 31, 2010 then it is called a “Covered Security” which also requires the reporting of the cost of that

security along with the calculated gain or loss and the determination of the character of the gain or loss as short-term or long term. We need these reports so make sure you provide those to us for each of the brokerage firms with whom you invested with this year.

Note that if the security was acquired prior to January 2011 the broker may not include the cost basis or date of acquisition with the 1099-B. If this is the case then you as the taxpayer are responsible for providing us that information so that we can properly prepare your return. If you are having difficulty in establishing the basis for some securities then make sure you let us know so that we can assist you in methods that you might be able to consider in calculating your basis.

- **1099-S Sale of Real Estate.** If you sold any real estate during 2014 then you should receive a Form 1099-S from the settlement company that handled the transaction. The 1099-S reports the gross selling price and date of sale. It does not report the basis so you need to be able to establish that amount in order for us to calculate your true capital gain or loss. If the property sold was your principal residence then in most cases the settlement company will not issue you the 1099-S because of the qualification of excluding the gain from the sale because you had owned and occupied the property as your principal residence for an accumulative period of 2 out of 5 years prior to the date of the sale and you did not have another qualifying sale within the last 2 years before the current sale. Let's discuss any sale of real property including any land and second homes.

- **1099-R Pension and Annuity Distributions.** If you received any distributions from an (IRA) or Employer Pension Plan (e.g. 401K plan etc.) then you should have received a Form 1099-R from each plan administrator. The 1099-R will report the total distribution as well as the taxable portion in some

cases. If the taxable portion is not determined on the 1099-R itself then you will need to establish that amount and you may need to make inquiries to the plan administrator. If you made any contributions to traditional IRA accounts which were not deducted then you should have been tracking this amount on IRS Form 8606 in the years in which you made those contributions. You and I should discuss these situations before completing your return.

- **IRA Contributions:** If you made any contributions to an IRA plan during 2014 then make sure you inform us of that and note that the contribution may be allowed as a deduction, is nondeductible or as a Roth contribution based on your specific circumstances and filing status and modified adjusted gross income. You must have "earned" income during 2014 in order to make a contribution to a plan. There is a special exception for an ex-spouse receiving alimony. Alimony is deemed to be "earned" income for purposes of an IRA contribution. In addition you should be aware that you can still make a contribution to an IRA up to and including April 15, 2015 for the 2014 year. You and I should discuss the options available and benefits of the various types of IRAs as far as deductible, nondeductible and Roth are concerned.

- **Form 1099-SSA: Social Security Benefit Statement** – If you are a Social Security recipient then you should receive a Form 1099-SSA from the Social Security Administration which reports your gross distribution and any Medicare premiums withheld for Medicare Part B and Part D. Whether or not your Social Security Benefits are includible in gross income depends on your filing status and level of income from other sources. Your inclusion amount could be zero, 50% or 85% of the gross benefit received. Call me to discuss these issues.

- **Alimony Issues:** If you receive payments from an ex-spouse then the determination of whether or not the amount received is includible in gross income as ali-

mony is dependent on all the issues as follows:

- The payments are specified in a valid divorce or separation agreement
- The payments must be in cash
- You did not live in the same household as the ex-spouse when the payments were made
- The payments cease upon the death of either party
- The agreement does not state that the payments are not alimony

Note that if the payments received qualify as income to the recipient then the payments are allowable as a deduction to the payor.

If your agreement requires that payments continue after your death to your estate or for the purpose to support your children then the receipts are not alimony to the extent of the continued payment amount and therefore those same amounts are not deductible by the payor.

In order for us to determine the proper treatment of payments as a result of your divorce you should provide us with a copy of your separation or divorce decree. In addition, if you are paying the alimony you will need to provide us with the Social Security number of your ex-spouse because the IRS requires this on your return and matches this information against the ex-spouse's return. If you are paying alimony to more than one ex-spouse then you must provide all social security numbers of those ex-spouses.

- **Form 1098-T Tuition and Fees Statement:** You should receive a Form 1098-T from each post-secondary educational institution to whom you paid tuition and fees during the year. These forms will be needed in order for us to calculate the proper educational benefits if any. The amount of tax benefits is based on your filing status and modified adjusted gross income. These benefits are not available if you are married

but file a return separate from your spouse. As far as tax credits are concerned the credit for the American Opportunity Credit is available for up to \$2,500 per eligible student on your return but the Lifetime Learning Credit of up to \$2,000 is only allowed for a return. The American Opportunity Credit is only available for the first 4 years of post-secondary education and the Lifetime Learning Credit is available for all post-secondary education. Let's discuss these issues and opportunities today.

- Form 1098-E Student Loan Interest: If you are paying interest on qualified educational loans then your payments may be deductible up to \$2,500 per return. It is important that these loans are your responsibility. You can not deduct interest on your child's loan if you aren't the debtor on those loans. If your parents are responsible for the loans then you can't deduct the interest even though you paid it because you aren't responsible for the debt. You also want to be aware that it is a per return deduction so if you were single in the prior year and were able to deduct the full \$2,500 amount and now are married in the current year you are still limited to only up to \$2,500 even if your new spouse also has their own interest payment of up to \$2,500 and were deducting it while they were single. If this is your issue then you will not be receiving the same benefit as single taxpayers. Let's discuss the importance of this issue.

- Form 1095-A Marketplace Statement: If you are an "applicable taxpayer" whose "household income" is *more than* 100% of the Federal Poverty Level (FPL) but not more than 400% of the FPL and you obtain your Minimum Essential Coverage (MEC) of Insurance through a State Exchange or Federal Facility (also called the "Marketplace") then you will receive a Form 1095-A Marketplace Statement which is going to report that you obtained MEC through the Marketplace and for which months you had the coverage. It is also going to list the months of coverage for each of your dependents for whom you are required

to maintain insurance. The 1095-A is going to provide the start date and termination date of coverage for each individual covered. The Form 1095-A will be needed in order for us to determine each month for which you qualify for a Premium Assistance Credit and we will report this data on new IRS Form 8962 Premium Tax Credit (PTC). The credit is available for each month you have coverage through the exchange on the first day of the month. Your Form 1095-A also provides the total amount of each monthly premium actually paid for your household for the Metal tier insurance that you selected. In addition the 1095-A will report what your premium would have been had you selected the Second Lowest Cost Silver Plan (SLCSP) Coverage. In addition when you selected your coverage you also told the Exchange whether or not you wanted them to pay any "Advanced Premium Assistance Credit" which was paid each month directly to your insurance company to help subsidize your premium payments. The amount of your subsidy was dependent on the "Household Income" you reported to them when you filled out your request for insurance coverage as well as your family size and marital status. If your "Household Income", marital status or family size changed during the year and you did not inform the Marketplace about those changes then the amount of your advanced credit could be more or less when we calculate the actual credit on your return. If the actual credit is more than the advanced credit then you will get more credit on your return which will cause your refund to be larger or your amount due to be smaller. If the actual credit is smaller than the advanced credit then you could owe money for the excess advance. However, the required repayment amount is limited based on where you are as far as the FPL and your filing status. Call me today to discuss this issue.

- Form 1095-B and Form 1095-C: Beginning January 1, 2014 every taxpayer is required to have health insurance coverage

which must provide minimal essential coverage (MEC). If a taxpayer does not have MEC for their self, spouse and each dependent on their tax return then they need to have an "exemption" for their self and/or the others for whom they are responsible. If they do not have MEC and don't have an exemption then they will have a "shared responsibility payment penalty".

As a result the information on Forms 1095-A, 1095-B and 1095-C will give us the data we need to determine your situation. If you do not have MEC and do not have an exemption then your shared responsibility payment will be the *greater of* a flat dollar amount of \$95.00 for up to 3 individuals or 1% of your household income but not greater than the national average cost of a bronze plan which is determined by Health and Human Services (HHS). That amount is \$204.00 per month (\$2,448 annually per person for 2014) with a maximum for 5 members of a household (\$12,240).

For purposes of the flat dollar amount of \$95 up to 3 individuals per household anyone who is 18 or older is counted as a full person and anyone under 18 is ½ of \$95 = \$47.50. Therefore you, your spouse and 2 children under 18 are the equivalent of a 3 persons therefore limited to 3 @ \$95 = \$285.

The shared responsibility payment is a monthly penalty and therefore only assessed for those specific months for which you do not have MEC or an exemption. Contact me for more details.

- Form 1098 Mortgage Interest: If you pay interest on a mortgage you should receive IRS Form 1098 which provides you with the total amount of mortgage interest paid, real estate taxes paid and any payments of points for the acquisition of a mortgage. The total amount of mortgage interest that is allowed to be deducted is based on the amount of debt on your principal residence and one second home. The debt limit is \$1,000,000 on acquisition debt on

the principal and second home and \$100,000 of debt on a home equity loan. If the total debt is not more than \$1,100,000 then acquisition debt can be \$1,100,000. Acquisition debt is debt incurred to buy, build or substantially improve your principal residence and second home. If the total debt is greater than \$1,100,000 then the amount of deductible interest is based on a ratio of \$1,100,000 over the average total debt for the year. In addition it is important to note that the home equity debt may not be deductible at all for the Alternative Minimum Tax unless the proceeds of the debt are traceable directly to buy, build or substantially improve the first or second home. Therefore, if you borrow \$60,000 and use only \$10,000 to invest in the home and the other \$50,000 is used for other purposes such as paying off credit cards, tuition etc. then only 1/6 of the total interest paid is deductible for the Alternative Minimum Tax on IRS Form 6251. If you have borrowed money against your home as part of a refinance and part of the refinanced debt is not qualifying debt then that portion of the interest also is not deductible for the Alternative Minimum Tax.

If the Form 1098 reports the payment of points then they are deductible in full in the current tax year only if the loan is a loan to buy build or substantially improve the "principal" residence. Points paid on an acquisition loan for a second home are not deductible in the year paid but instead are amortized over the life of the loan. The same is true if the points are paid for the refinance of debt on a principal and/or second home. If you need to understand more about mortgage interest deductions give us a call.

- Rental Property and Passive Activity Loss (PAL). If you own a rental property then you can deduct up to \$25,000 each year if you "actively participate" in the management of the specific property. The \$25,000 amount is subject to a phase out rule which reduces the \$25,000 amount by .50 cents

on each \$1.00 above \$100,000 of modified adjusted Gross Income (AGI). Therefore the \$25,000 is completely phased out at \$150,000 of modified AGI. Any loss not deducted in the current tax year is suspended and carried forward to the next tax year and subject to the same limitations. The suspended losses are allowed to be used in the subsequent years when your modified AGI is under the threshold amounts; there is passive income on the subsequent years or the rental property is sold in a fully taxable event between unrelated parties. For this purpose a related party is the parent, grandparent, child, grandchild, brother, sister or spouse of the taxpayer. It also includes any partnership or corporation in which the selling taxpayer owns 50% or more of the interest as well as being the beneficiary or fiduciary of an estate or trust. If you sold a rental property or are thinking about selling let's discuss the tax issues in order to understand the impact of the sale. You also should contact me if you are thinking about the acquisition of a rental property.

- Trade or Business Issues: If you are operating a trade or business as a Sole Proprietorship then you are required to file a Schedule C with your Form 1040. If you have more than one trade or business then you are required to file a separate Schedule C for each activity. You cannot report more than one activity on only one Schedule C.

As a sole proprietor your most important issue is keeping books and records and if there is a failure to do so an audit of your trade or business could result in additional tax, interest and penalties. It is my recommendation that we discuss setting up a proper set of accounting records for you so that you are able to track every possible business deduction available to you. The law allows you to deduct any ordinary and necessary business expenditure necessary in order to try to earn the next dollar of income.

As a sole proprietorship you could have deductions which include a salary for your spouse and children who provide a true function to your business. They can have health benefits which are allowed as a deduction on your Schedule C which also reduces your self-employment tax and saves you an additional 15.3% of your income. By paying a salary to your children you can reduce your income by up to \$6,200 in 2014 and \$6,300 in 2015 and the child's income would not be taxed. If the child is under age 18 then no Social Security tax or Medicare tax needs to be deducted from their wages and you as the employer are not required to match the tax.

You could qualify for a home office deduction as long as you have a space that you use *regularly and exclusively* for business purposes. It is a must that no personal use of the specific space is ever used. Qualifying for the home office deduction will then give you the use of a portion of any mortgage interest, real estate taxes, homeowners insurance and dues, utilities etc. Also you will be permitted to deduct the depreciation on the space used *regularly and exclusively*. The true value of qualifying for the home office is the deductibility of your automobile because each mile is now a business mile. The automobile deduction comes in the form of either a standard mileage rate of .56 cents per mile in 2014 and .57.5 cents per mile in 2015 or a ratio of actual expenses based on business miles divided by total miles driven in the year. You will need to track your miles in order to have a valid record. If you want to know more about the opportunities for operating a trade or business as a Sole Proprietorship then let's talk about it soon.

I look forward to servicing you this tax season but gather all of these applicable important documents and anything else you have that you need to discuss about your tax and financial needs and opportunities.