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JUNE 2014

TIMELY FILING

Taxpayers continue to learn that "timely mailing is timely filing" is not always true. In a recent Tax Court case, *Sanders versus Commissioner of Internal Revenue*, the Tax Court ruled that a filing sent one day before the last date for filing using "United Parcel Service Ground" service was not a timely filing because it was received after the last day for filing. Had the filing been mailed one day before its due date using U.S. Postal Service Certified Mail, the filing would have been timely as it was placed with an approved carrier before the due date. Some, but not all, private delivery services are acceptable to the Revenue Service and the Tax Court, but sorting them out is complex. This case again demonstrates the wisdom of using the U.S. Postal Service Certified Mail whenever proof of timely filing is necessary.

WHICH TAX RECORDS TO RETAIN – AND FOR HOW LONG

After filing your 2013 income tax returns, you might be considering disposing of some past years' tax information. However, you will want to remember the rules for retaining relevant tax records in the event that the IRS — or another taxing authority — wants you to produce those records as part of an audit.

Individual Taxpayers

Keep at Least Three Years — The following records are commonly used to substantiate a taxpayer's income and expense items:

- Form(s) W-2
- Form(s) 1099
- Form(s) K-1
- Bank and brokerage statements
- Canceled checks or other proof of payment of deductible expenses
- For charitable contributions of more than $250, checks are not sufficient. Receipts are required by law.

At a minimum, the above tax records should be kept for a three-year period following the date that you file your return (or its due date, if later).

Six Years is Better — The IRS's time limit for initiating an audit asserting that income was grossly understated (but without fraud), is six years. Accordingly, you should retain the above documents for at least six years for self-protection.

Investment Records — Similarly, you will want to keep investment sales records after you liquidate an investment. Documentation that substantiates the gain or loss on an investment should be kept for the period that you retain other tax documents supporting the return on which you report the sale.

Prior Years' Tax Returns — It is a good idea to maintain one or more permanent files with important legal and personal documents, including those relating to taxes. Specifically, as a general rule, you should retain copies of your federal and state income tax returns (and any tax payments) *indefinitely*.

For instance, the IRS (or another taxing authority) could claim that you never filed a particular year's return. If that occurs, the IRS could assess tax and penalties relating to the return in question. You will need a copy of your return to bolster your position that you actually filed the return.

(Continued on reverse)

Pass-through Business Entities — If you are an owner in an S corporation, LLC, LLP, or partnership, you should retain a copy of the annual Schedule K-1 for as long as you own an interest in the entity *plus four additional years.* Also, keep any paperwork related to the sale or other disposition of your interest for at least four years after the disposition.

Business Taxpayers

It is an employer's responsibility to keep accurate, up-to-date records. Similar to the concern of an individual taxpayer, businesses need to be prepared for the possibility of an audit.

Employment Tax Records — Employment tax records must be maintained for at least four years after the later of the due date of the tax return for the period to which the records relate or the date the tax is paid. The penalties for noncompliance can be harsh. These records should include the following information:

- Employer identification number (EIN);
- Amounts and dates of all wage, annuity, and pension payments;
- Amounts of tips reported;
- The fair market value of in-kind wages paid;
- Names, addresses, Social Security numbers, and occupations of employees and recipients;
- Employee copies of Forms W-2 that were returned as undeliverable;
- Employees' dates of employment;
- Periods for which employees and recipients were paid while absent due to sickness or injury, and the amount and weekly rate of payments made to them by the employer or third-party payers;
- Copies of employees' and recipients' income tax withholding allowance certificates (Forms W-4, W-4P, W-4S, and W-4V);
- Dates and amounts of tax deposits;
- Copies of returns filed;
- Documentation for allocated tips; and
- Documentation for fringe benefits provided, including appropriate substantiation.
- Forms I-9 and supporting documentation must be retained as long as the person is employed and after termination, for three years after date of hire or one year after termination, whichever is later.

Corporate Income Tax Returns — It is highly advisable that you retain copies of all corporate income tax returns *indefinitely.*

Other Business Records — In addition, you should keep the following business records indefinitely:

- Board minutes
- Bylaws
- Business licenses
- Contracts, leases and mortgages
- Patents/Trademarks
- Shareholder records
- Stock registers/transactions
- Employee benefit plans, including pension/profit sharing plans
- Real estate purchases
- Construction records
- Leasehold improvements
- Annual financial statements
- Fixed asset purchases
- Depreciation schedules

The following business records should be retained for at least seven years:

- Accounts Payable/Receivable
- Inventory records
- Loan payment schedules
- Expense records
- Sales records
- Purchase orders
- Bank statements
- Cancelled checks
- Loan records
- Electronic payment records
- Payroll records

Filing your tax returns is the first step in properly handling your taxes. However, making sure you can defend yourself in event of an audit is also important.

Electronic Storage — Taxpayers who utilize computers with scanners and with confidence in their backup procedures might want to consider using electronic storage for some of their records. Nonetheless, we encourage retention of the hard copies of income tax returns.

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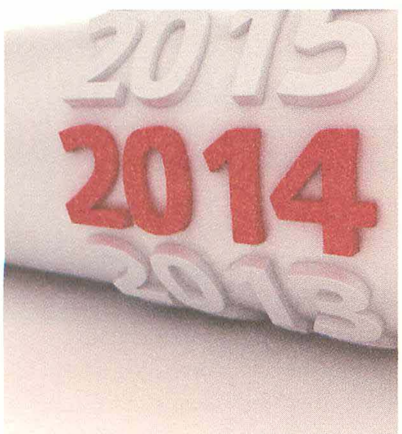
Tax & Business Alert

JUNE 2014

IRS TOUGHENS THE ONE-YEAR WAIT BETWEEN IRA ROLLOVERS

IRA rollovers are a popular way of obtaining a short-term tax-free loan from an IRA. To receive tax-free treatment, the amount withdrawn from the IRA must be redeposited into the same or another IRA no later than 60 days after the taxpayer received the distribution (the 60-day requirement). In addition, the tax-free rollover privilege is limited to one rollover within any one-year period. The one-year period starts on the date the amount rolled over was received—not the date it was rolled over.

For years, the IRS has held that the one-year waiting period between IRAs applies separately to each IRA. This taxpayer-friendly interpretation allowed taxpayers with multiple IRA accounts to roll over two or more distributions during a 12-month period, provided each was from a different account.



However, the IRS has adopted the Tax Court's recent unfavorable interpretation of the one-IRA-rollover-per-year rule, which considers all the taxpayer's IRAs together for the limitation. To ease the pain, they have provided some transitional relief and will not apply the new, stricter interpretation to any rollover involving a distribution that occurs before January 1, 2015. So there is still a little time to take advantage of the current, more liberal, rules.

Example: Transitional relief for the one-IRA-rollover-per-year rule.

Stella desperately needs cash, but only for a relatively short time. She wants to temporarily use the funds held in her three traditional IRAs (IRA-1, IRA-2, and IRA-3). In 2014, Stella takes $75,000 out of IRA-1. Fifty-nine days later (still in 2014), she withdraws $75,000 from IRA-2 and deposits that amount back into IRA-1. Fifty-nine days after that (still in 2014), she withdraws $75,000 from IRA-3 and deposits the amount back into IRA-2. Fifty-nine days after that, her cash crunch is over, and Stella deposits $75,000 back into IRA-3.

Under the transitional rule, Stella is effectively able to borrow $75,000 from her IRAs for almost half a year without any tax consequences via three tax-free rollover transactions because all the IRA distributions rolled over were withdrawn before January 1, 2015.

Variation: If Stella withdraws the $75,000 from IRA-3 in January of 2015, she will fall outside the transitional relief (because it only applies to distributions occurring before January 1, 2015). Therefore, the distribution from IRA-3 cannot be rolled over because she already used up her one-IRA-rollover-per-year privilege with the earlier rollovers in 2014.

Please contact us to discuss this IRA law change and the beneficial aspects of IRAs that have not changed. ■

EXPENSES QUALIFYING FOR THE CHILD CARE CREDIT

Working parents can find summer child care solutions challenging. However, a nonrefundable credit is available if the qualifying child care expense is incurred so that you (and your spouse, if married) can work. The maximum credit is 20%–35% (depending on your adjusted gross income) of the lesser of (1) your qualifying child care expenses up to $3,000 for one and $6,000 for two qualifying individuals or (2) your earned income (or your spouse's, if less).

Qualified child care expenses provide for the well-being and protection of a dependent child under age 13 and must be reduced by the amount of any employer-provided dependent care benefits. Amounts paid for food and education generally are not considered work-related expenses; however, services that are incidental to and cannot be separated from the costs of caring for a child are not excluded from the credit. Therefore, expenses paid to a daycare center are usually eligible for the credit, whereas summer school or tutoring expenses are not. The cost of day camp should qualify for the credit; however, overnight camps are not considered work-related and don't qualify.

If you pay someone to come to your home and care for your dependent child, you may be a household employer required to withhold and pay social security and Medicare tax and pay federal unemployment taxes. Keep these rules in mind as you plan summer childcare. ■

MID-YEAR TAX PLANNING IDEAS

Tax planning is a year-round process, so now is a good time to think about the following—

- Are you considering making a cash gift to a relative? If so, consider making the gift in conjunction with the overall revamping of your stocks and mutual funds held in taxable brokerage accounts to achieve better tax results. Don't gift loser shares (currently worth less than you paid for them). Instead, sell these shares, recognize the capital loss on your tax return, and then gift the cash proceeds to a relative. However, do gift winner shares to lower tax bracket relatives (unless they are under age 24 and subject to Kiddie Tax). The 2014 annual gift tax exclusion is $14,000.
- Are you considering making a contribution to a favorite charity? The previous strategies will also work well for contributions to qualified charities. Sell loser shares, recognize the loss on your tax return, then give the cash proceeds to the charity and claim the resulting charitable contribution (if you itemize). Donate winner shares to the charity and deduct the full current fair market value at the time of the gift (without being taxed on the capital gain). The tax-exempt organization can sell your donated shares without owing tax.
- Are you self-employed? Consider employing your child in the business (but pay a reasonable wage for their age and work skills). This practice can shift income (which is not subject to the Kiddie Tax) to the child who is normally in a lower tax bracket, decrease payroll taxes, and enable the child to contribute to an IRA.
- Is your estate plan current? If you already have an estate plan, it may need updating to reflect the current estate and gift tax rules. For 2014, the unified federal gift and estate tax exemption is a generous $5.34 million, and the rate is 40%. Furthermore, the impact of the Supreme Court's *Windsor* decision and resulting IRS changes in the federal definition of marriage mean that legally married same-sex couples need to revise their estate plan. Plus, there may be non-tax reasons to update your estate plan.

Please contact us to discuss any tax planning strategies you are interested in implementing. ■

TIPS FOR BUSINESSES THAT OUTSOURCE PAYROLL DUTIES

Many employers outsource their payroll and related tax duties to third-party payers such as payroll service providers and reporting agents (often referred to as service bureaus). Reputable payroll service bureaus can help employers streamline their business operations by collecting and timely depositing payroll taxes on the employer's behalf and filing required payroll tax returns with state and federal authorities.

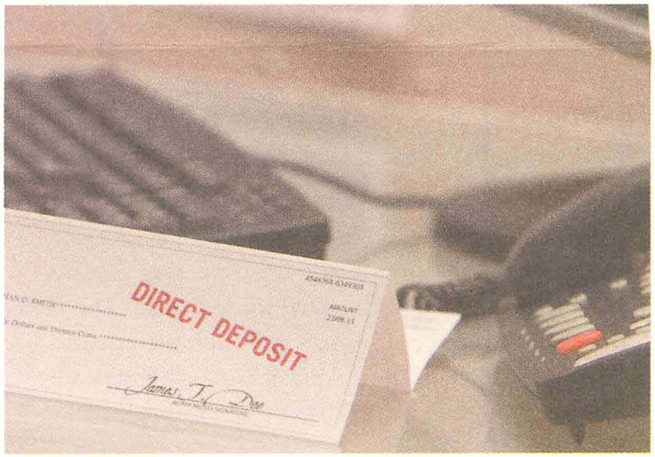
Though most payroll service bureaus provide very good service, there are, unfortunately, some who do not have their clients' best interests at heart. Over the past year, a number of these companies have been prosecuted for stealing funds intended for the payment of payroll taxes. So, a thorough background investigation is essential.

There are several different types of payroll service bureaus. Regardless of the type your business uses, it's important to understand that the service bureau is only acting as an agent. This means state and federal tax authorities will hold you—the employer—responsible for the service bureau's errors or omissions.

Like employers who handle their own payroll duties, employers who outsource payroll duties are still legally responsible for any and all payroll taxes due. This includes any federal income taxes withheld as well as both the employer and employee's share of social security and Medicare taxes. This is true even if the employer forwards tax amounts to the service bureau to make the required deposits or payments.

If you use a service bureau to process some or all of your payroll functions, here are some steps you can take to protect the company from unscrupulous service bureaus.

- Be familiar with your payroll tax due dates. Require the payroll service provider to provide timely proof that it has actually performed the requested services.
- Consider performing some payroll activities yourself. For example, you could ask the service bureau to prepare the withholding reports and send them to you for review. After reviewing the reports, you can make the deposit directly.
- Investigate the service bureau's financial condition and credit standing, both initially and on a periodic basis thereafter. How are the company's funds isolated from financial problems to which the bureau or its other clients may suffer, and what coverage and conditions apply to fiduciary bonds for service bureau employees? This is important because little protection or recourse is available to employers whose service bureau misuses funds intended for payroll tax payments and then goes bankrupt. Having the funds held in trust will also protect the funds from an IRS levy of the service bureau's bank account.
- Document clearly in the contract the service bureau's policy on indemnifying the company for interest and penalties that the service bureau's errors cause.
- Make sure your service bureau uses the Electronic Federal Tax Payment System (EFTPS) to make tax deposits. Then, enroll in and use EFTPS to check your company's payment history to ensure the service bureau is properly carrying out its tax deposit responsibilities.



- Use your company's address (not the service bureau's) as the address on record with the IRS. Doing so ensures that the company will continue to receive bills, notices, and other account-related correspondence from the IRS. It also provides a way to monitor the service bureau and easily spot any improper diversion of funds.
- Contact the IRS about any bills or notices as soon as possible. This is especially important if it involves a payment that the service bureau should have made. Call the number on the bill, write to the IRS office that sent the bill, or contact the IRS business tax hotline at 800-829-4933.

If you have any questions, please give us a call.

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IRS WARNS TAXPAYERS TO BEWARE OF PHISHING SCAMS

Phishing is a scam typically carried out by unsolicited email and/or bogus websites posing as legitimate sites luring unsuspecting victims to provide personal and financial information. The IRS has recently warned consumers to watch for emails appearing to be from the Taxpayer Advocate Service (TAS) that include a bogus case number. The email may include the following message, "Your reported 2013 income is flagged for review due to a document processing error. Your case has been forwarded to the Taxpayer Advocate Service for resolution assistance. To avoid delays processing your 2013 filing contact the Taxpayer Advocate Service for resolution assistance." The email may contain links appearing to provide information about the "advocate" assigned to the recipient's case but actually lead to web pages soliciting personal information.

If you receive an email claiming to be from the IRS that contains a request for personal information, do not reply to the email, open any attachments, or click on any links. Instead, forward the email to the IRS at *phishing@irs.gov*. After forwarding the email to the IRS, delete the original email you received.

Remember—the IRS, including the TAS, does not initiate contact with taxpayers by email, text, or any social media.

If you receive a phone call from an individual claiming to be from the IRS but you suspect they are not an IRS employee: (1) ask for a call back number and employee badge number, and (2) contact the IRS to determine if the caller is an IRS employee with a legitimate need to contact you. If you determine it is a legitimate call, then call the IRS employee back or call us to handle it for you. If you receive a notice or letter via paper mail, contact us to help you determine if it is a legitimate IRS letter. If it is a legitimate IRS letter, we can help you reply if needed. For information on How to Contact the IRS, see *www.irs.gov/uac/How-to-Contact-the-IRS-1*. If either the caller or letter is not legitimate, report the incident to the Treasury Inspector General for Tax Administration at *www.treasury.gov/tigta/contact_report.shtml*. ■