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MAY 2014

THE ROLLOVER TRAP

The enclosed *Tax and Business Alert* contains an article on page 3 discussing avoiding penalties on IRA withdrawals before age 59½. We agree with the discussion of the avoidance of possible premature withdrawal penalties. The article points out in the second-to-last paragraph that "In a time of economic need, an IRA can be a source of liquidity even before age 59½. If the need is short-term, an IRA withdrawal and redeposit of the same amount within 60 days can be tax-free." That statement is also correct, but the important word is "can."

Setting the Trap

The Internal Revenue Service has issued annually, for many years, Publication 590, *Individual Retirement Arrangements (IRAs)*, which has long stated that withdrawals from an IRA and redeposit of the same amount within 60 days into the same or another IRA are tax-free rollovers. The current issue of Publication 590 includes, on page 25, an example as follows:

> *"You have two traditional IRAs, IRA-1 and IRA-2. You make a tax-free rollover of a distribution from IRA-1 into a new traditional IRA (IRA-3). You cannot, within 1 year of the distribution from IRA-1, make a tax-free rollover of any distribution from either IRA-1 or IRA-3 into another traditional IRA. However, the rollover from IRA-1 into IRA-3 does not prevent you from making a tax-free rollover from IRA-2 into any other traditional IRA. This is because you have not, within the last year, rolled over, tax-free, any distribution from IRA-2 or made a tax-free rollover into IRA-2."*

The example makes it clear, at least according to the Revenue Service's Publication 590, that a taxpayer can have more than one tax-free rollover during a one-year period as long as the taxpayer originally had two IRAs. You are, according to the Internal Revenue Service, allowed to make a rollover from each IRA once per year, per IRA. In other words, beginning with two IRAs, you could have two rollovers. The trap is set.

The Trapped – Mr. and Mrs. Bobrow

The Tax Court has ruled in favor of the Internal Revenue Service, upholding an asserted deficiency in Bobrow vs. Commissioner, stating that "a taxpayer who maintains multiple IRAs may not make a rollover contribution from each IRA within one year." The Tax Court opinion is dated January 28, 2014. The website edition of IRS Publication 590 has, however, not been changed.

The Future Rule

IRS Announcement 2014-15 states new regulations will provide that the rollover limitation will be on an aggregate basis (one rollover per year, regardless of the number of IRAs), but the new regulation will not be effective (enforced) before January 1, 2015.

A Better Way

In addition to rollovers, the law allows direct "custodian-to-custodian" transfers – that is,

(Continued on reverse)

the IRA owner has the funds or in-kind assets transferred directly from one custodian to the new custodian. Such transfers are not "rollovers" under the rules, are not subject to frequency limitations, and are unlimited by law. Because of the greater possibility of error, questioning, etc., we suggest that direct "custodian-to-custodian" transfers be used whenever changing IRAs.

SOLAR ENERGY SYSTEMS TAX CREDIT DECREASING

Both the Louisiana and federal income tax laws include credits for solar energy systems.

The Louisiana Legislature in Act No. 428 of the 2013 Regular Session made numerous changes in the former Wind and Solar Energy Systems Louisiana tax credit. The credit after 2013 is only for solar electric and solar thermal or a combination of the two. The Act also repealed the residential rental apartment complex credit. The solar credit is, after 2013, available only for "a single-family detached dwelling." For systems installed after December 31, 2013 and before June 30, 2014, the credit is 38 percent of the first $25,000 of the cost of the purchase of the system down from 50 percent for systems installed before January 1, 2014. In addition to decreasing maximum cost base and maximum credit limits, the credit is also limited by a decreasing cost-per-watt limitation. The changes in the credit, which expire December 31, 2017, are detailed in the following table:

Period	Credit%	Maximum Cost Base	Maximum Credit	Cost per Watt Limitation
7/1/13 – 12/31/13	50%	25,000	12,500	$4.50 per watt
1/1/14 – 6/30/14	38%	25,000	9,500	$4.50 per watt
7/1/14 – 6/30/15	38%	21,000	7,980	$3.50 per watt
7/1/15 – 12/31/17	38%	12,000	4,560	$2.00 per watt

Federal law allows for 2013 through 2016 a tax credit (not subject to income limitations) of 30 percent of the cost (unlimited) of solar panels, solar water heaters, etc. for new and existing homes, including rental residences. A Louisiana income tax credit (described above) is available equal to 38 percent (but not more than $9,500 or $4.50 per watt) of the first $25,000 of the cost as described above. After June 30, 2014, the Louisiana credit drops to a maximum of $7,980 (or $3.50 per watt). For higher cost systems, the 30 percent unlimited federal credit is more significant than the 38 percent (limited cost) Louisiana credit. Using both credits, Louisiana taxpayers can receive, in 2014, income tax credit totaling 68 percent of the first $25,000 expended and 30 percent on the amount above $25,000.

For example, a solar energy system purchased in 2014, before June 30, for $25,000 can result in a Louisiana tax credit of $9,500 and a federal tax credit of $7,500 (total credits of $17,000), resulting in a net-of-credit cost of $8,000 or 32 percent of the purchase price. The federal tax credit will generally be realized in the year in which the equipment is acquired. The Louisiana credit will be fully utilized in the year that the equipment is installed and placed in service by offsetting the owner's Louisiana income tax liability. Also, any credit in excess of the Louisiana tax liability is refundable to the owner. The purchase in 2014, before June 30, of a $50,000 system can result in a Louisiana credit of $9,500 and a federal credit of $15,000 for a net cost of $25,500.

The Louisiana Public Service Commission has established net metering rules that require the utility companies to provide a net meter to customers to measure the flow of electricity accurately in both directions. The excess solar energy generated by a home system can be sold back to the utility company. A detailed analysis of the cost effectiveness of solar energy generation by homeowners in Louisiana remains complex. Nonetheless, the largest cost is the acquisition and installation of the equipment and the credits have significantly reduced the cost for residential systems.

If you are interested in a renewable energy system, you might want to consider it for 2014 before the credit decreases further. We will be glad to discuss solar tax credits with you.

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Tax & Business Alert

MAY 2014

LEASING PROPERTY TO A CLOSELY-HELD CORPORATION

Shareholders of closely-held C corporations routinely lease real estate, equipment, and other property to their corporate entity. These leases can be held directly by the shareholder or through a separate entity, such as a partnership, LLC, or S corporation.

Of course, the corporation could directly purchase the item or lease it from an independent source. However, advantages that can motivate these leasing arrangements include the following:

a. *Avoiding Payroll Taxes.* Rental income from real estate is not subject to self-employment (SE) tax. A lease of real estate to a closely-held corporation represents the ability to withdraw funds from the corporation without incurring social security or Medicare (FICA) taxes.

b. *Avoiding Corporate-level Gain.* Retaining ownership of real estate and other valuable tangible or intangible assets outside the corporation avoids the potential for triggering a gain within the corporation at either distribution or liquidation of the assets. If appreciated assets (those with an FMV in excess of adjusted tax basis) are distributed from a corporation, whether in liquidation or other form of distribution, gain must be recognized.

c. *Retirement Cash Flow.* Retaining valuable assets outside a controlled corporation allows the shareholder-lessor to continue to receive a cash flow stream in the form of rent or royalties, even though the shareholder is no longer actively employed by the corporation. This can allow a portion of the corporation income to flow to a retired shareholder or a shareholder who is uninvolved in the business operations.

d. *Business Transition.* Retaining assets outside the corporation provides a natural segregation between the ownership of the business and the ownership of business assets. For example, a controlling shareholder-lessor may want to divest ownership and control of the business operations by disposing of some or all of the corporate stock, but retain a portion of the business assets for lease to the entity. This can help transfer ownership and control to a successor by minimizing the value of the corporation (e.g., when the corporation contains only operating assets, such as receivables and inventory, with fixed assets retained by the founder).

As you plan your business operations, keep these potential advantages in mind. It is also important to understand that, as with most areas of tax law, some restrictions and limitations apply to shareholder-to-corporation leasing transactions. Therefore, please contact us to discuss the details of how these arrangements should be structured before you sign the lease. ■

TAXING A CHILD'S INVESTMENT INCOME

Some children who receive investment income are required to file a tax return and pay tax on at least a portion of that income (and possibly at the parents' marginal tax rate). This is often referred to as the kiddie tax. The kiddie tax cannot be computed accurately until the parents' income is known. Thus, the child's return may have to be extended until the parents' return has been completed. Additionally, if the parents' return is amended or adjusted upon IRS audit, the child's return could require correction (assuming the changes to the parental return affect the tax bracket). If a child cannot file his or her own tax return for any reason, such as age, the child's parent or guardian is responsible for filing a return on the child's behalf.

There are tax rules that affect how parents report a child's investment income. *Investment income* normally includes interest, dividends, capital gains, and other unearned income, such as from a trust. Some parents can include their child's investment income on their tax return. Other children may have to file their own tax return. Special rules apply if a child's total investment

income is more than $2,000. Finally, the parents' tax rate may apply to part of that income instead of the child's tax rate.

Note: Higher income individuals subject to the 3.8% net investment income tax (3.8% NIIT) may benefit from shifting income to and having their child claim investment income on the child's tax return. This may be advantageous because the child receives his or her own $200,000 exclusion from the 3.8% NIIT. ■

DON'T BE A CHARITY SCAM VICTIM

When a natural disaster strikes, thieves often play on the goodwill of people by posing as representatives of real charities to steal money or get information to commit identity theft.

Bogus charities use several different tactics to get money and information from unsuspecting individuals. They may claim to be with, and use the names similar to legitimate charities. They often use email to steer people to bogus websites that look like real charity websites. Scam artists will contact people by phone or email to get their victims to donate money or give them financial information. To avoid being scammed, don't give your social security number, credit card information, bank account numbers, or passwords to anyone.

Only donations to qualified organizations are tax-deductible. For legitimate charitable contributions, contribute by check or credit card to provide documentation for tax purposes—never donate cash. Finally, if you suspect fraud, report it to the appropriate authorities. ■

TAXABLE TIP INCOME

If you receive tips on the job from customers, you must include those tips in the computation of your tax liability, if any. This includes tips directly from customers, tips added to credit cards, and your share of tips received under a tip-splitting agreement with other employees. The method for paying out charge tips is determined by the employer. Charge tips can be distributed daily or accumulated and paid through regular payroll. The value of noncash tips, such as tickets, passes, or other items of value, are also subject to income tax.

If you receive $20 or more in tips in any one month, from any one job, you must report your tips for that month to your employer. The report should only include cash, check, and debit and credit card tips you receive. Your employer is required to withhold federal income, social security, and Medicare taxes on the reported tips. You are not required to report the value of any noncash tips to your employer, but they are taxable. ■

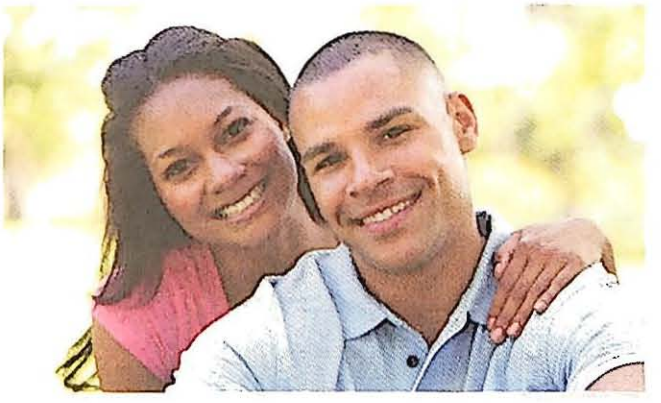
AVOIDING PENALTIES ON IRA WITHDRAWALS BEFORE AGE 59½

IRA owners can withdraw money from their account at any time and for any reason because the owner is in total control of this account. Most withdrawals from traditional IRAs will be at least partially taxable. To add insult to injury, the taxable portion of a withdrawal made before age 59½, referred to as an "early withdrawal," will be subject to a 10% penalty tax. (This penalty can be as high as 25% on early withdrawals from a SIMPLE IRA.) Finally, there can even be a 10% penalty tax assessed on a nontaxable portion of some early withdrawals from Roth IRAs.

The 10% penalty tax was implemented to encourage long-term saving for retirement, which is clearly a sound financial objective. But, sometimes financial circumstances make it necessary to withdraw retirement-oriented savings before age 59½. If you must make an early withdrawal, there are some ways to avoid the penalty tax. Early withdrawals from IRAs, including traditional IRAs, SEP accounts, SIMPLE IRAs, and Roth IRAs, can be exempt from the premature withdrawal penalty tax in the following cases:

- Withdrawals that count as substantially equal periodic payments (SEPPs) using an IRS-approved method.
- Withdrawals for medical expenses in excess of specific AGI levels.
- Withdrawals by military reservists called to active duty.
- Withdrawals for IRS levies.
- Withdrawals paid to a deceased plan participant's estate or beneficiary after death.
- Withdrawals after becoming physically or mentally disabled.
- Withdrawals for first-time home purchases ($10,000 lifetime limit).
- Withdrawals for qualified higher education expenses.
- Withdrawals to pay health insurance premiums during unemployment.

Unlike early withdrawals from a qualified plan [e.g., 401(k)], the penalty exception allowing early withdrawals paid to the plan participant's spouse or ex-spouse or dependent under a Qualified Domestic Relations Order (QDRO) pursuant to divorce proceedings is not available for early IRA distributions.



Caution: If a taxpayer chooses to take SEPPs, these payments must be calculated correctly using an IRS-approved method and taken for the requisite number of years. Otherwise, all pre-age-59½ withdrawals will be hit with the 10% penalty tax!

In a time of economic need, an IRA can be a source of liquidity even before age 59½. If the need is short-term, an IRA withdrawal and redeposit of the same amount within 60 days can be tax-free. If the need is long-term and before age 59½, the withdrawal may be fully or partially taxable, but one of the previously listed exceptions may be used to avoid the 10% early withdrawal penalty.

Please contact us to discuss IRA withdrawals before age 59½ or any other tax compliance or planning issue. ■

DIRTY DOZEN TAX SCAMS FOR 2014

The "Dirty Dozen," compiled by the IRS each year, lists common scams that taxpayers encounter. Unsurprisingly, tax fraud using identity theft tops the list this year. Next on the list is telephone scams, with callers pretending to be from the IRS in an effort to steal money or identities from their victims. You can find the complete 2014 Dirty Dozen listing by going to www.irs.gov and entering "dirty dozen" in the search box. ■

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TAXING SOCIAL SECURITY BENEFITS

Some taxpayers must include up to 85% of their social security benefits in taxable income, while others find that their benefits are not taxable at all. If social security is your only source of income, your benefits probably won't be taxable. In fact, you may not even need to file a federal income tax return. If you get income from other sources, however, you may have to pay taxes on at least a portion of your social security benefits. Your income and filing status will also affect whether you must pay taxes on your social security benefits.

A quick way to find out if any of your benefits may be taxable is to add half of your social security benefits to all your other income, including any tax-exempt interest. Next, compare this total to the following base amounts. If your total is more than the base amount for your filing status, then some of your benefits may be taxable. The three base amounts are:

- $25,000 for single, head of household, qualifying widow or widower with a dependent child, or married individuals filing separately and who did not live with their spouse at any time during the year.
- $32,000 for married couples filing jointly.
- $0 for married persons filing separately who lived together at any time during the year.

To avoid tax time surprises, social security recipients can request that federal income tax be withheld from their benefit payments. Withholding is voluntary and can be initiated by completing IRS Form W-4V (Voluntary Withholding Request), requesting to have 7%, 10%, 15%, or 25% (those are the only choices) withheld for federal income tax, and submitting the form to the local Social Security Administration office. Voluntary withholding can be stopped by completing a new Form W-4V. ■