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SEPTEMBER 2014

INTERNAL REVENUE SERVICE AUDITS INCREASE

The Internal Revenue Service (IRS) is substantially increasing its coverage through the use of two major automated examination systems. According to the IRS, in the fiscal years 2008 through 2012, it conducted 5.7 million correspondence examinations resulting in $40.4 billion in additional taxes. For 2010, the IRS reports that it conducted 1.4 million individual income tax return examinations and 3.9 million under-reporter cases (W-2s, 1099s, and other information returns) in addition to generating 564,000 automated substitute returns for those failing to file but for whom information returns were received. As a result of regular examinations and the automated examinations, the audit coverage rate for individuals with incomes below $100,000 increased from one percent to 6.9 percent and from 0.6 percent to 7.3 percent for individual taxpayers with incomes between $100,000 and $200,000. Audits on those above $200,000 are, we believe, significantly higher.

Since there are numerous notices generated and required response dates in a correspondence audit, we encourage our tax clients, if contacted by the IRS, to contact us and to send us a copy of any written notice or request for information. Since the IRS is entitled only to that information necessary to correctly determine your tax, we might be able to spare you some problems in the examination and to assist you with responding appropriately to the IRS's information requests.

"WHAT HAS BEEN DONE WILL BE DONE AGAIN"

These words of Solomon are certainly true when it comes to breaches of trust and theft. That some people are not trustworthy is, unfortunately, a harsh lesson that is taught and retaught when a trusted associate is caught stealing. It is impossible to prevent employee dishonesty losses cost-effectively in small organizations. However, the adherence to a few basic rules will significantly reduce the likelihood and extent of such losses. We hope you will consider the following for your organization.

An effective system of internal control separates the duties and responsibilities of employees in a manner that provides for the safeguarding of assets and generation of accurate data. In small organizations, ideal internal control is difficult to achieve because it is so difficult to separate duties. There are

(Continued on reverse)

certain steps, however, that the manager or owner can take to strengthen internal control. Some of these are:

1. Personally open and review your monthly bank statement. (This one monthly effort would probably result in the early detection of most disbursement thefts.) Look carefully at your cancelled checks or check copies and question anything that you do not understand prior to giving the statement to the employee who prepares the bank reconciliation.
2. Require that supporting documents (which bear approval and evidence of receipt of goods or services) accompany checks presented for signature. Documentation should be marked "paid" with the date and the check number to prevent its reuse.
3. Restrict signature authority on checks to employees who do not have access to accounting records.
4. Be aware of the basic procedures of your system (however informal) and set a good example by adhering to these procedures. Understand your procedures for paying and receiving funds, consider apparent weaknesses, and make the necessary adjustments.
5. Require that all cash received be deposited daily and intact, whether or not convenient. Require that all control forms for collections, charges, invoices, etc., be completed daily.
6. Require that vacations be taken and ensure that all of the vacationing employee's duties are performed by another person.
7. Restrict access to petty cash and change funds to one employee.
8. Do not allow any check cashing or borrowing from cash on hand.
9. Use employee fidelity bonds. (Please see following article).

Adherence to a few common sense rules and alertness by the owner or manager will prevent most employee misappropriation in small businesses. In almost all cases of losses in small business, two or more of the above policies were not followed.

EMPLOYEE FIDELITY INSURANCE

You might want to purchase insurance covering employee dishonesty. Many small businesses can be so insured with modest premiums. It makes good sense to have such insurance since cash and record handling in small businesses is often done by the same people. The source of employer resistance to such insurance is usually not the cost but, rather, the employer's concern that long-term employees might be offended by being asked to complete the questionnaires, etc. sometimes necessary for bonding. In spite of the cost and the possible offense to some employees, we believe such insurance should be carried. You might want to discuss this coverage with your agent.

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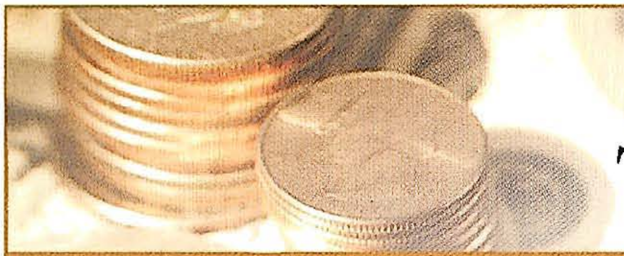


Tax & Business Alert

SEPTEMBER 2014

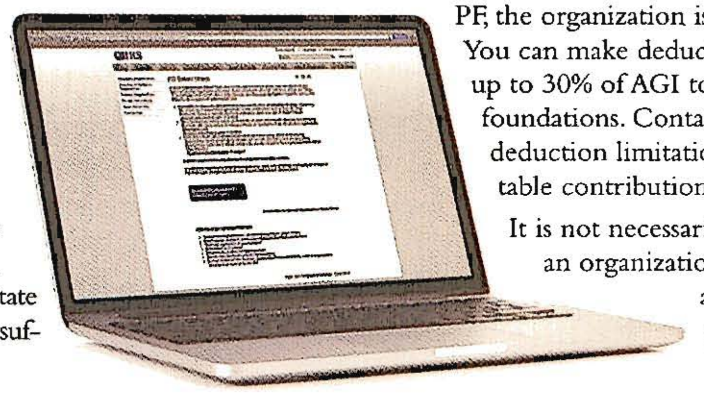
IDENTIFYING CHARITIES ELIGIBLE TO RECEIVE TAX DEDUCTIBLE CONTRIBUTIONS

If you're counting on a federal income tax deduction for donating to a charity, you should confirm that the *charity* has been approved by the IRS as a tax-exempt organization eligible to receive deductible contributions.

For some charities, this is easy—everybody knows the American Red Cross, the Salvation Army, and Goodwill are IRS-approved tax-exempt charities. But what about verifying that tax deductions are allowed for contributions to less well-known charities? Good question.

To determine which organizations are tax-exempt outfits eligible to receive deductible contributions, follow this procedure.

- Access the IRS website home page at *www.irs.gov.*
- At the top of the home page, enter "EO Select Check" in the search bar.
- Click on "EO Select Check."
- Click on the blue "Exempt Organizations Select Check Tool" box.
- Under "Limit search to organizations that (select only one)," select "Are eligible to receive tax-deductible contributions."
- To the extent you've got the requested information, fill in the blanks for the charity you're searching for. You probably won't have the charity's EIN, but if you know its name and the city and state where it's located, that should be sufficient. Hit the search key.
- A (probably long) list of charities will appear. Scroll down until you find the one you're looking for. By clicking on the arrow beside the "Legal Name" link at the top of the list, you can order the list alphabetically by name of organization. You can also organize the list by the cities where organizations are located.
- Once you find the line for the charity you're searching for, click on the "Deductibility Status" link on the far right. For example, if the status is PC, the organization is a public charity (the most common kind). You can make deductible donations of up to 50% of your adjusted gross income (AGI) to one or more public charities. (AGI is the number at the bottom of page 1 of your Form 1040; it includes all your income items and subtractions for certain deductible items such as IRA contributions, alimony paid to an ex-spouse, and self-employed health insurance premiums.) If the organization's status is SOUNK, the outfit is an organization that supports a public charity. You can make deductible contributions of up to 50% of AGI to such organizations. If the status is PF, the organization is a private foundation. You can make deductible contributions of up to 30% of AGI to one or more private foundations. Contact us for details on the deduction limitations that apply to charitable contributions.



It is not necessarily a deal-breaker if an organization is not on the IRS-approved list. For example, some churches and

Continued on Page 2.

Identifying Charities continued.

church-related organizations may not appear on the IRS website's list of tax-exempt organizations because they are not actually required to apply to the IRS for tax-exempt status. For a non-church organization, not being on the IRS-approved list doesn't necessarily mean it's not IRS-approved, but serious skepticism is appropriate. If you're still considering a contribution, ask the organization to send you a copy of the IRS determination letter that recognizes its tax-exempt status.

It's smart to be skeptical about making significant contributions to organizations that claim to be tax-exempt organizations. Taking the steps outlined in this letter is probably a good idea even if you don't care about a tax write-off. If you have questions or want more information about deducting charitable contributions, please contact us.

DEDUCTING MEDICALLY NECESSARY HOME IMPROVEMENTS

Individuals can claim medical tax deductions for the cost of special equipment installed in a home, or for home improvements, if the main purpose is to accommodate the individual's, spouse's, or dependents' medical needs. Medically required home improvements that would not ordinarily be for medical care are deductible only to the extent the costs exceed the increase in the home's value.

Certain home improvements made to accommodate a disabled condition do not usually increase the value of the home, and the cost can be included in full as medical expenses. These improvements include, but are not limited to, the following items:

- Moving or modifying electrical outlets and fixtures.
- Installing porch lifts and other forms of lifts. (Exception: Elevators generally add value to the house.)
- Installing railings, support bars, or other bathroom modifications.
- Constructing entrance or exit ramps.
- Widening doorways at entrances or exits.
- Widening or modifying hallways and interior doorways.
- Lowering or modifying kitchen cabinets and equipment.
- Modifying stairways.
- Adding handrails or grab bars.
- Modifying hardware on doors.
- Modifying fire alarms, smoke detectors, and other warning systems.
- Modifying areas in front of entrance and exit doorways.
- Grading the ground to provide access to the residence.

UNNEEDED LIFE INSURANCE POLICIES COULD BE A SIGNIFICANT SOURCE OF CASH

Besides providing loved ones with a source of funds for income replacement in the event of an untimely death of the family's breadwinner(s), people buy life insurance for a variety of reasons:

- To fund a buy-sell agreement or key person insurance for a business.
- To satisfy a lender's requirement when a loan was made.
- To fund expected estate taxes that might have decreased since the policy was taken out.

Whether it was one of these needs or something else, circumstances change and sometimes people find that they no longer need, or perhaps can no longer afford, policies that were taken out several years ago.

If this describes your situation, before you allow a term life policy to lapse (or turn in a whole life policy for its cash surrender value), we recommend that you consider whether it might be more beneficial to sell the policy. Known in the industry as a *life settlement*, selling a policy can sometimes net the policyholder a sufficient sum that's far in excess of a whole life policy's cash surrender value or a term policy's unearned premium. An ideal candidate for a life settlement is an insured individual over the age of 70 who no longer needs or wants the life insurance policy and who has experienced a significant change in health since the policy was bought.

If you have an unneeded policy that you're thinking about getting rid of or just letting it lapse, we'd be glad to talk to you about whether it might make sense to try to sell it instead.

PAYING PARTNERSHIP EXPENSES

Individual partners are often required to incur business expenses that will not be reimbursed by the partnership (such as travel and entertainment expenses). Partners are generally not entitled to deduct partnership expenses on their individual income tax returns. However, if the partnership's agreement or practice requires a partner to pay certain partnership expenses from his or her own funds, with no right to reimbursement from the partnership, the partner is entitled to deduct, in arriving at AGI (on Schedule E), these as trade or business expenses on his or her personal return. These Schedule E deductions should also generally be deducted in computing net self-employment income on Schedule SE.

Strategy: Partners should make explicit the "requirement" that partners incur partnership expenses without right of reimbursement, either as a provision of their partnership agreement or through a written policy of the partnership.

SMALL BUSINESS RESOURCES

If you are a small business owner, here is a list of organizations that may have tools, information, and other resources to help your business grow.

Business USA (*business.usa.gov*). The mission of Business USA is to be a centralized, one-stop platform for businesses to access government services to help them grow and hire. Business USA uses technology to connect businesses to the services and information relevant to them, regardless of where the information is located or which government agency's website, call center, or office they go to for help.

Department of Agriculture—Office of Small & Disadvantaged Business Utilization (OSDBU) (*www.dm.usda.gov/osdbu*). The mission of the OSDBU is to provide maximum opportunities for small businesses to participate in USDA contracting activities by establishing and attaining small disadvantaged business program goals.

Department of Commerce (*www.commerce.gov*). The Commerce Department's mission is to create the conditions for economic growth and opportunity by promoting innovation, entrepreneurship, competitiveness, and stewardship.

Department of Labor: Occupational Safety & Health Administration (OSHA) (*www.osha.gov*). OSHA's mission is to assure the safety and health of America's workers by setting and enforcing standards; providing training, outreach, and education; establishing partnerships; and encouraging continual improvement in workplace safety and health.

GobiernoUSA.gov (*www.usa.gov/gobiernousa*). The U.S. government's official Spanish language web portal.

Service Corps of Retired Executives (SCORE) (*www.score.org*). SCORE is a nonprofit organization that is federally supported to provide free business mentoring and low-cost training to aspiring and existing business owners.

Small Business Administration (SBA) (*www.sba.gov*). The mission of the SBA is to maintain and strengthen the nation's economy by enabling the establishment and viability of small businesses and by assisting in the economic recovery of communities after disasters.

Small Business Development Centers (SBDCs) (*www.sba.gov/sbdc*). SBDCs, which are located across the U.S., are hosted by leading universities and state economic development agencies. SBDC advisors provide free business consulting and low-cost training services including business plan development, financial packaging and lending assistance, exporting and importing support, procurement and contracting aid, and healthcare guidance.

Social Security Administration (*www.ssa.gov*). The Social Security Administration is the nation's primary income security agency. It pays retirement, disability, and survivors benefits to workers and their families; administers the Supplemental Security Income program; and issues Social Security numbers.

State and Local Contacts (*www.statelocalgov.net*). The State and Local Government on the Net directory provides convenient one-stop access to the websites of thousands of state agencies and city and county governments.

U.S. Department of Labor (DOL) (*www.dol.gov*). The DOL administers a variety of federal labor laws, including those that guarantee workers' rights to safe and healthful working conditions, a minimum hourly wage and overtime pay, freedom from employment discrimination, unemployment insurance, and other income support.

U.S. Equal Employment Opportunity Commission (EEOC) (*www.eeoc.gov*). The mission of the EEOC is to eradicate employment discrimination at the workplace.

USA.gov. The U.S. government's official web portal.

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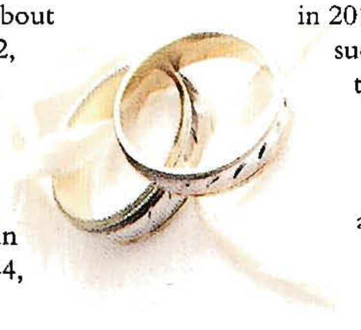
WEDDINGS MEAN TAX CHANGES

It may not be as high on the wedding plan checklist as the venue, invitations, and attire, but there are important tax issues created by a marriage that warrant some prompt attention following the wedding.

Name change. Any time names are changed, it should be reported to the Social Security Administration (SSA). The name associated with an individual's Social Security Number (SSN) should match the name on the tax return. To change a name with the SSA, file Form SS-5, *Application for a Social Security Card*. The form is available from *www.ssa.gov*, by calling (800) 772-1213, or from the local SSA office.

Address change. Let the IRS know about an address change by filing Form 8822, *Change of Address*. Also notify the U.S. Postal Service at *www.usps.com* to forward mail. You may also report the change at your local post office.



Change tax withholding. A change in marital status requires a new Form W-4, *Employee's Withholding Allowance Certificate*, be furnished to the employer(s). Combined incomes may move the taxpayers into a higher tax bracket. Search *www.irs.gov* for the IRS Withholding Calculator tool for help completing the new Form W-4.

Change in filing status. Marital status is determined as of December 31st each year. Spouses can choose to file jointly or separately each year. We can help you make that determination by calculating your tax liability both ways.

Change in circumstances. Taxpayers receiving an advance payment of the healthcare premium tax credit in 2014 should report changes in circumstances, such as a change in income or family size, to the Health Insurance Marketplace. Also, the Marketplace should be notified when you move out of the area covered by your current Marketplace to ensure you get the proper type and amount of financial assistance. ■