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**APRIL 2015**

## THANKS
## TO CLIENTS AND STAFF

We will celebrate the Wednesday, April 15 completion of the filing season with our traditional holiday by closing the accounting office on the following day, Thursday, April 16. The computer center will be open. We will honor our staff with an appreciation luncheon at noon on Friday, April 17, and we will be closed (including the computer center) that afternoon. We are indebted to our staff for their excellent performance and to our clients for the opportunities of working for them. To both staff and clients – ***Thank you!***

## FUNDING TAX FAVORED SAVINGS PLANS
**(NOW IS THE TIME)**

The income tax filing season is for many taxpayers also the season for funding tax deductible Individual Retirement Accounts (IRAs), profit-sharing plans, 401(k)s etc.

### Eligibility

All taxpayers with earned income, regardless of income levels, who are under 70½ years of age are eligible for traditional IRA contributions. Eligibility for employment-related plans is limited by the plan document. For taxpayers covered by retirement plans at work, income limitations apply to deductible traditional IRA contributions but not to non-deductible traditional IRA contributions. High-income taxpayers are not allowed direct contributions to Roth IRAs, but can convert traditional IRA balances to Roth IRA balances. Accordingly, any taxpayer under age 70½ with earned income can fund a Roth IRA by first making a non-deductible contribution to a traditional IRA and then by rolling the traditional IRA balance to a Roth IRA. (The conversion will be taxable if you have other traditional IRA balances)

### Roth Advantage

Unlike traditional IRAs and traditional employer plans from which distributions must begin at age 70½, Roth IRAs do not require lifetime distributions and offer the great advantage of tax-free (not merely tax-deferred) compounding for the full lifetime of the saver. If a spouse is the Roth IRA beneficiary, the Roth balance can continue to compound tax-free without required distributions until the death of the spouse. Both Roth and traditional tax-favored plans inherited by a beneficiary other than a spouse must be distributed over the life expectancy of the beneficiary determined in the year after the date of death of the account owner.

### Early Funding (What a Difference a Year Makes)

Making contributions to tax-favored savings plans early in each year increases the balances available for compounding and, over long periods, will result in significantly increased

*(Continued on reverse)*

accumulations. For example, an annual contribution of $1,000, made on the last day of each year, for the 21 years ended December 31, 2014 would, at the S&P 500 Index rate of return, accumulate to $61,007. That same $1,000 deposit on the first day of each year would have compounded to $66,225 at December 31, 2014. If extended to 31 years, the January 1 deposit would compound to $181,158 and the December 31 deposit would compound to $166,749.

## Contribution Limits for 2015

The IRS has announced the 2015 contribution limits for both employer-sponsored plans and IRAs. The increased limits provide some individuals with opportunities for additional tax savings.

**Employer-sponsored Plans**

*401(k), 403(b), and most 457 plans*. In 2015, employees may defer up to $18,000 in earnings (up from $17,500 in 2014). For those 50 and older, the limit on supplemental "catch-up" contributions has increased from $5,500 to $6,000.

*Defined contribution plans*. The dollar limit on "annual additions" (generally, combined contributions of the employee and employer) to a participant's account in a defined contribution plan, such as a 401(k) plan or a basic profit sharing plan, has increased from $52,000 to $53,000 for 2015.

*SIMPLE IRAs*. The general limit on employee contributions to a SIMPLE IRA has increased from $12,000 to $12,500. The allowable catch-up contribution for employees 50 and older has increased from $2,500 to $3,000.

**Individual Retirement Accounts**

The limit for contributions to both traditional and Roth IRAs remains unchanged at $5,500, as does the $1,000 limit on catch-up contributions.

Individuals who contribute to traditional IRAs and have workplace retirement plans, however, will be allowed to have slightly more income in 2015 before they can no longer deduct their IRA contributions.

- For single taxpayers and heads of household who are covered by a retirement plan at work, the deduction is phased out once modified adjusted gross income (MAGI) is between $61,000 and $71,000 (up from $60,000 and $70,000 for 2014).

- For married couples filing jointly when the spouse contributing to the IRA is also covered by a workplace retirement plan, the deduction is phased out once joint MAGI is between $98,000 and $118,000 (up from $96,000 and $116,000 for 2014).

- For married couples filing jointly when the spouse contributing to the IRA is not the spouse with the workplace retirement plan, the deduction is phased out once joint MAGI is between $183,000 and $193,000 (up from $181,000 and $191,000 for 2014).

Similarly, the income phase-out levels for Roth IRA contributions have also increased.

- For single taxpayers and heads of household, the income phase-out range is $116,000 to $131,000 (up from $114,000 to $129,000 for 2014).

- For married couples filing jointly, the income phase-out range is $183,000 to $193,000 (up from $181,000 to $191,000 for 2014).

We are convinced that maximizing contributions to tax-favored retirement accounts (and making them as early as possible) are priorities of long-term savings. We will be pleased to discuss any questions you may have.

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# Tax & Business Alert

APRIL 2015

## CONTEMPORANEOUS RECORDKEEPING KEY TO AVOIDING LOSS LIMITATIONS

Taxpayers who run up tax losses in a business must be prepared to prove that one of the material participation tests was passed to avoid having the losses characterized as a passive activity loss (PAL) that cannot be currently deducted. Adequate *contemporaneous* records that detail the taxpayer's tasks and time spent in the activity are crucial in attempting to sidestep the PAL rules. Records created after-the-fact are better than nothing, but they are much less believable than contemporaneous records. If losses are disallowed by the IRS, interest and penalties may be added to the unpaid taxes.

In general, an individual taxpayer can meet the material participation standard by passing one of the following seven tests outlined in the regulations:

- *More-Than-500 Hours.* This test is passed if the taxpayer spends more than 500 hours in the activity during the tax year in question.
- *More-Than-100 Hours and More-Hours-Than-Anyone-Else.* This test is passed if the taxpayer participates in the activity for more than 100 hours during the tax year and no other taxpayer participates more, including taxpayers who are not owners.
- *Substantially All.* This test is passed if the individual's participation in the activity for the year constitutes substantially all of the participation in the activity for all individuals (including non-owners).
- *Significant Participation Activity.* This test is met if the individual's aggregate participation in all activities in which he or she participated for more than 100 hours during the year (significant participation activities) exceeds 500 hours for the year.
- *Material Participation in the Last Five Years.* This test is passed if the individual materially participated in the activity for any five tax years during the 10 immediately preceding years.
- *Personal Service Activity.* This test is passed if the individual materially participated for any three preceding tax years by performing services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting.
- *Facts and Circumstances.* This test is passed if, based on all facts and circumstances, the taxpayer is found to have participated in the activity on a regular, continuous, and substantial basis during the year in question.

In attempting to pass the material participation tests, taxpayers can prove their participation levels by any reasonable means. This can include identifying the types of work performed and the approximate number of hours spent performing such work with contemporaneous appointment books, calendars, narrative summaries, and the like. Several court decisions have said that while the regulations permit flexibility regarding what it takes to prove material participation, courts are not required to accept after-the-fact "ballpark guesstimates" or a taxpayer's unverified, undocumented, and presumably self-serving testimony. ■

## SPECIAL RULES FOR INHERITED IRAS

Normally, retirement plan distributions made to a nonspouse beneficiary after the account owner's death are taxable at the time they are received and cannot be rolled over to the beneficiary's own IRA. However, employer-sponsored retirement plans are required to offer nonspouse beneficiaries the option to roll over inherited amounts tax-free in a direct (trustee-to-trustee) rollover to an *inherited* IRA.

No taxes will be due on the inherited IRA rollover until the beneficiary receives a distribution from the inherited IRA. An *inherited* IRA is an IRA that has been acquired by a beneficiary on the death of someone other than a spouse.

The following special rules apply to an inherited IRA:

- The IRA must be a brand-new IRA set up for the specific purpose of receiving the inherited account.
- The IRA must be specially titled in the deceased account owner's name.
- No other contributions may be made to the IRA.
- No other amounts may generally be rolled into or out of the IRA.
- Minimum required distributions will need to be made over the beneficiary's life expectancy starting the year after the IRA owner's death. ■

## AVOID GIFT TREATMENT BY PAYING EXPENSES DIRECTLY

The annual exclusion for gifts remains at $14,000 for 2015 (married couples can gift up to $28,000 combined). This limit applies to the total of all gifts, including birthday and holiday gifts, made to the same individual during the year. However, any payment made *directly* to the medical care provider (e.g., doctor, hospital, etc.) or educational organization for tuition is not subject to the gift tax and, therefore, is not included in the $14,000 limit.

So, when paying tuition or large medical bills for parents, grandchildren, or any other person who is not your dependent minor child, be sure to make the payment *directly* to the organization or service provider. Don't give the funds to the parent or other individual first and have them pay the school, doctor, or hospital. By doing so, you have made a gift to that person, subject to the $14,000 limit. In summary, make direct payments to schools or medical providers and avoid taxable gifts that could be subject to the gift tax or reduce the payer's unified credit.

**Caution:** Direct payments of tuition reduce the student's eligibility for financial aid on a dollar-for-dollar basis. However, if the gift were made directly to the student, only 20% of the gifted assets would be counted as assets of the student for financial aid purposes. Accordingly, careful analysis of the trade-offs between the gift tax exclusion and impairment of financial aid eligibility should be considered. ■

### TAX CALENDAR

**April 15**

- Besides being the last day to file (or extend) your 2014 personal return and pay any tax that is due, 2015 first quarter estimated tax payments for individuals, trusts, and calendar-year corporations are due today. So are 2014 returns for trusts and calendar-year estates, partnerships, and LLCs, plus any final contribution you plan to make to an IRA or Education Savings Account for 2014. SEP and Keogh contributions are also due today if your return is not being extended.

**June 15**

- Second quarter estimated tax payments for individuals, trusts, and calendar-year corporations are due today.

# SEPS—ONE LAST CHANCE TO LOWER YOUR 2014 TAX BILL

Simplified Employee Pension (SEP) plans are sometimes regarded as the "no-brainer" first choice for many high-income small business owners who do not currently have tax-advantaged retirement plans set up for themselves because of the generous amounts that can be contributed. Unlike other types of retirement plans, a newly formed SEP is easy to establish and a powerful retroactive tax planning tool. SEPs are available to self-employed individuals, partnerships (including multi-member LLCs treated as partnerships), and corporate employers alike.

On the downside, (1) SEP contributions must be made for all eligible employees using the same percentage of compensation as for the owner, and (2) employee accounts are immediately 100% vested. Of course, these apply only if the business has employees other than the owner.

## CONTRIBUTION AMOUNTS

Contributions to SEPs are discretionary. The business can decide what amount of contribution it will make each year. The contributions are made to SEP-IRAs established for each eligible employee.

For 2014, the maximum contribution that can be made to a SEP-IRA is 25% of compensation (or 20% of self-employed income net of the self-employment tax deduction) of up to $260,000, subject to a contribution cap of $52,000. For example, for 2014, a sole proprietor with $100,000 of net self-employment earnings could contribute up to $20,000 to his or her SEP-IRA.

## DUE DATE FOR ESTABLISHING AND CONTRIBUTING TO A SEP

A SEP plan can be established as late as the due date (including extensions) of the business's tax return for the tax year for which the SEP is to first apply. For example, a sole proprietor has until April 15, 2015 to establish a SEP for 2014 (October 15, 2015 if his return is extended). Furthermore, he has until April 15, 2015 (October 15, 2015 if the return is extended) to make the 2014 contribution and still claim a potentially hefty deduction on the 2014 return. Generally, other types of retirement plans must be established by the end of the year for which they are to first apply.

## ESTABLISHING A SEP IS EASY

A SEP plan is established by completing and signing the very simple Form 5305-SEP (Simplified Employee Pension—Individual Retirement Accounts Contribution Agreement). Form 5305-SEP is not filed with the IRS, but it should be maintained as part of the self-employed person's or employer's permanent tax records. A copy of Form 5305-SEP must be given to each employee covered by the SEP along with a disclosure statement.

## ELIGIBLE EMPLOYEES

If employer contributions are made for a year, they must be made on behalf of all eligible employees and may not discriminate in favor of highly compensated persons. For 2014, an eligible employee for SEP participation purposes is one who has (1) attained age 21, (2) performed any services for the employer during at least three of the preceding five years, and (3) received at least $550 in compensation.

## ANNUAL REPORTING REQUIREMENTS

SEPs have no annual reporting requirements with the IRS. However, the employer must give each participating employee an annual statement of contributions. If the contribution is made before year-end, the information should be included on the employee's Form W-2. If the contribution is made after year-end (but on or before the due date of the employer's income tax return for the year), the employee should be notified on a separate statement by the later of (1) 30 days after the contribution is made or (2) January 31 following the calendar year for which the contribution was made.

If you think a SEP plan might be good for your business, please give us a call. ■

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## WHAT LANDLORDS SHOULD KNOW ABOUT RENTAL INCOME AND EXPENSES

*Rental income* is any payment received for the use or occupation of property. Rental income is generally included in gross income when actually or constructively received. Cash basis taxpayers report income in the year received, regardless of when it was earned. Expenses of renting property can be deducted from gross rental income. Rental expenses are generally deducted by cash basis taxpayers in the year paid.


*Advance rent* is any amount received before the period that it covers. Include advance rent in rental income in the year received, regardless of the period covered or the accounting method used.

Do not include a security deposit in income when received if it is to be returned to the tenant at the end of the lease. If part or all of the security deposit is retained during any year because the tenant does not live up to the terms of the lease, include the amount retained in income for that year. If an amount called a security deposit is to be used as a final payment of rent, it is advance rent. Include it in income when received.

If the tenant pays any expenses that are the landlord's obligations, the payments are rental income and must be included in income. These expenses may be deducted if they are otherwise deductible rental expenses. Property or services received in lieu of rent are reportable income. Include the fair market value of the property or services in rental income. Services at an agreed upon or specified price are assumed to be at fair market value unless there is evidence to the contrary.

Personal use of a vacation home or other rental property requires that the expenses be allocated between the personal and rental use. If the rental expenses exceed rental income, the rental expenses will be limited. ■