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FEBRUARY 2015

STEPHANIE CARROLL
NEW CPA

We were very pleased to learn recently that Stephanie Carroll has successfully completed the CPA exam.

Stephanie grew up in Florien and graduated from Louisiana Tech. She came to work with us in October 2013 after having previously worked in public accounting with a national firm.

We are very happy with Stephanie in her success and are very fortunate to have her services.

NEW FOR 2014 INCOME TAX RETURNS
HEALTH INSURANCE PENALTY

The U. S. Government has released an estimate that as many as six million households will pay the new penalty tax for not having had the mandated health insurance coverage during all of 2014. About two to four percent of the 150 million taxpayers who file returns are expected to pay the penalty, which can be up to nearly one percent of the household's income.

Your tax return preparer will need to know whether or not you had the health insurance coverage as required by law. Taxpayers who had the required coverage for all of 2014 will have to report their compliance in their income tax return filing to prevent the imposition of the penalty.

CURRENT INTEREST RATES AND LONG-TERM TAX PLANNING

That interest rates are at historic lows is well understood. How long this period of relatively low rates will last is, of course, unknowable. Taxpayers concerned with long-term income tax and estate tax planning might want to consider the possibility of using the current interest rates to make plans for and to transfer assets tax-effectively to younger generations (estate tax planning) and to share current income (if desired, without loss of control) with younger, lower bracket family members (income tax planning). The applicable federal rate (AFR) is mentioned in the accompanying *Tax and Business Alert* as being useful in aiding an adult child with the financing of a home. It also offers greater benefits in other ways.

If the AFR or a higher rate is used for loans between related parties, the Internal Revenue Service will accept that rate as valid and will not impute and tax income based on a higher rate or impute a gift from the lender. For February 2015, the long-term (more than nine

(Continued on reverse)

years) AFR rate is 2.41 percent. The mid-term AFR rate (more than three years and nine years or less) is 1.70 percent. The short-term AFR (three years or less) is .48 percent. With rates at their current levels, it is probably a good time to consider transferring assets with significant appreciation potential, a good (or increasing) income stream, or both to younger family members by gift, sale, or by a combination of both.

Even without low interest rates, creation of a family investment entity with the related valuation discounts allows gifts and/or sales to younger family members and often results in significant income and estate tax savings without the loss of asset management and control by the senior generation. Such planning also eases the administrative cost and burdens on the surviving family members, which often, even without tax benefits, justifies the expense of the entity. It is even more effective when combined with the current low interest rates.

We will be happy to discuss your income tax and estate planning with you.

INVESTOR'S CHOICE

One of the earliest diversified equity index mutual funds, the Vanguard 500 Index Fund, became available August 31, 1976. Since that time, such funds have grown amid much discussion of their pros and cons. According to the *Wall Street Journal* (*Investors Shun Stock Pickers*, January 4, 2015), investors are now increasingly choosing index funds over actively managed funds. *Morningstar* reports that in 2014 about 74 percent of the actively managed stock funds in the United States underperformed their benchmark indices. *Morningstar* also states that the average fee for actively managed stock mutual funds was $1.24 per year for each $100 invested. Diversified index funds are available from Vanguard for as little as five cents per year per $100.

We have long believed that low-cost, diversified equity index funds produce better after-tax results than funds relying on the market timing and stock picking abilities of more expensive active managers. Our conclusion is not based solely on the better pre-tax performance of such funds, but for taxable accounts also on their more favored tax status – that is, the tax-deferred or even tax-free appreciation (if held to death) of passive equity index funds. Accordingly, with the better income tax status and better performance of such funds, it is not surprising to find that investors are increasingly choosing them.

In so choosing, investors are following the recommendation of Warren Buffett, probably the most successful investor in history, who has, for many years, recommended diversified equity index funds as the core holding for investors. Burton G. Malkiel, Professor of Economics at Princeton University, and widely acclaimed author, and David F. Swenson, who greatly increased the Yale Endowment and is one of the most successful money managers in history, both also recommend diversified equity index funds as the best option for investors. We continue to believe that buy-and-hold investors who cost-effectively acquire and hold diversified equity index funds for long periods of time enjoy a substantial accumulation advantage over investors who pay higher management fees and significantly higher current income taxes on capital appreciation because of the high turnover of active management.

The advantages of diversified equity index fund holdings are becoming more widely recognized. We believe such funds should be seriously considered by all seeking financial security.

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Tax & Business Alert

FEBRUARY 2015

HELPING AN ADULT CHILD BUY A HOME

Economic and tax considerations make right now a good time for parents (and grandparents) who are willing and able to help their adult children buy a home. Some residential real estate markets are "hot" with homes selling for more than asking price. In other markets, the prices are recovering, but are still at lower levels than a few years ago. With mortgage interest rates at historically low levels, now may be a great time to buy a home. In addition, there are some favorable tax factors that will help. How long this good scenario will last is anyone's guess, but we would bet not too much longer.

BENEFICIAL TAX FACTORS

0% Capital Gains Rate. For 2015, taxpayers in the 10% and 15% tax brackets for regular taxable income will enjoy a 0% tax rate on long-term capital gains (LTCGs). Thus, your child won't pay any federal income taxes on any LTCGs they realize this year to the extent his or her taxable income (including LTCGs) does not exceed $74,900 if married and filing jointly, $50,200 if head of household, or $37,450 if single. So, if the child's income (after the standard deduction and personal exemptions) will fall in this range in 2015 and you hold appreciated stocks and mutual fund shares in taxable brokerage firm accounts, you could give him or her some shares.

The child can then sell them and use the proceeds to help finance his or her home purchase. Gains will be long-term (and federally income tax free) if your ownership period plus his or hers is over a year.

As long as the stock you give your child this year is worth $14,000 or less (when combined with any other gifts to the same child), your taxable estate is reduced without any adverse federal gift or estate tax consequences—thanks to the annual gift tax exclusion privilege ($14,000 for 2015 gifts). Married taxpayers can double this amount—they can give up to $28,000 ($56,000 if the child is married) this year without triggering adverse estate and gift tax consequences. You can give away even more than these amounts if you don't mind dipping into your $5.43 million federal gift and estate tax exclusion.

Low Federal Interest Rates. If additional funds are needed for your child to purchase a home, you might want to consider loaning the additional funds to him or her. Now is a very good time for taking this step too. With loans between family members, the Applicable Federal Rate (AFR) is a big deal. Why? Because that's the rate the lending parent can charge without causing any unwanted tax complications. Currently, AFRs are very low by historical standards, so making a loan that charges the AFR is a great way for a parental lender to give an adult child borrower a favorable loan without having to deal with the complicated below-market loan rules. ■

THE IMPORTANCE OF ACCOUNTABLE EXPENSE REIMBURSEMENT PLANS

Most companies cover their employees' business expenses by reimbursing them for their actual expenses or by paying a travel or mileage allowance. Such arrangements are subject to strict tax rules concerning what qualifies as a legitimate reimbursement arrangement and what is treated (at least for tax purposes) as additional compensation to the employee.

According to the tax rules, the key distinction between a true expense reimbursement and disguised compensation is whether the employer's payments are made in accordance with what the IRS calls an *accountable plan* (such a plan basically requires employees to substantiate all reimbursed expenses and return any advances in excess of expenses incurred).

If an employer has an accountable plan in place, expense reimbursements and allowances to employees, who properly comply with the terms of the plan, are deductible by the company (subject to the 50% limit for most meals and entertainment expenses) and nontaxable to the employees.

If a company maintains a nonaccountable plan or an employee fails to comply with the company's accountable plan, expense reimbursements and allowances are still deductible by the company. However, they are taxable to the employee as compensation. Thus, such amounts are included on the employee's Form W-2 and subject to income tax withholding. In addition, both the employer and employee are subject to employment taxes on such payments. Although the employee is allowed an offsetting deduction for the expenses reported on his or her Form W-2, the deduction is claimed as a miscellaneous itemized deduction and thus normally provides little or no tax benefit.

Because the tax ramifications of a nonaccountable expense reimbursement plan are so unfavorable for employees and are potentially unfavorable for the employer, companies generally should use an accountable plan for employee expense reimbursements.

If you would like our help in establishing such a plan for your business (or in ensuring that your current reimbursement policy complies with the requirements for such a plan) please contact us. We would be glad to assist you. ■

STANDARD MILEAGE RATES FOR 2015

Rather than keeping track of the actual cost of operating a vehicle, employees and self-employed taxpayers can use a standard mileage rate to compute their deduction related to using a vehicle for business. Likewise, standard mileage rates are available for computing the deduction when a vehicle is used for charitable, medical, or moving purposes.

The 2015 standard mileage rates for use of a vehicle are 57.5 cents per mile for business miles (up from 56 cents per mile in 2014), 23 cents per mile for medical or moving purposes, and 14 cents per mile for rendering gratuitous services to a charitable organization.

The business standard mileage rate is considerably higher than the charitable and medical/moving rates because it contains a depreciation component. No depreciation is allowed for the charitable or medical/moving use of a vehicle.

In addition to deductions based on the business standard mileage rate, taxpayers may deduct the parking fees and tolls attributable to the business use of an automobile, as well as interest expense relating to the purchase of the automobile and state and local personal property taxes. However, employees using a vehicle to perform services as an employee cannot deduct interest expense related to that vehicle. Also, if the vehicle is operated less than 100% for business purposes, the taxpayer must allocate the business and nonbusiness portion of the allowable taxes and interest deduction. ■

EMPLOYER REIMBURSEMENTS OF INDIVIDUAL HEALTH INSURANCE POLICIES

For plan years beginning after 2013, the Affordable Care Act (ACA) institutes so-called market reform provisions that place a whole host of new restrictions on group health plans. The penalty for violating the market reform restrictions is a punitive $100-per-day, per-employee penalty; or $36,500 per-employee, per-year. With a limited exception, these new market reform provisions significantly restrict an employer's ability to reimburse employees for premiums paid on individual health insurance policies, referred to as *employer payment arrangements*.

EMPLOYER PAYMENT ARRANGEMENTS

Under employer payment arrangements, the employer reimburses employees for premiums they pay on their individual health insurance policies (or the employer sometimes pays the premium on behalf of the employee). As long as the employer (1) makes the reimbursement under a qualified medical reimbursement plan and (2) verifies that the reimbursement was spent only for insurance coverage, the premium reimbursement is excludable from the employee's taxable income. These arrangements have long been popular with small employers who want to offer health insurance but are unwilling or unable to purchase group health coverage.

Unfortunately, according to the IRS and Department of Labor (DOL), group health plans can't be integrated with individual market policies to meet the new market reform provisions. Furthermore, according to the DOL, an employer that reimburses employees for individual policies (on a pretax or after-tax basis) has established a group health plan because the arrangement's purpose is to provide medical care to its employees. Therefore, reimbursing employees for premiums paid on individual policies violates the market reform provisions, potentially subjecting the employer to a $100 per-day, per-employee ($36,500 per-year, per-employee) penalty.

Limited Exception for One-employee Plans. The market reform provisions do not apply to group health plans that have only one participating employee. Therefore, it is still allowable to provide an employer payment arrangement that covers only one employee. Note, however, that nondiscrimination rules require that essentially all full-time employees must participate in the plan.

Bottom Line. While still technically allowed under the tax code, employer payment arrangements, other than arrangements covering only one employee, are no longer a viable alternative.

WHAT SHOULD YOU DO IF YOU STILL HAVE AN EMPLOYER PAYMENT PLAN?

First of all, don't panic. You are not alone. The impact of the market reform provisions to these plans has come as a great surprise to many small business employers, not to mention the tax practitioner community, and we believe there is reasonable cause to keep the penalty from applying for earlier payments. However, it is important to discontinue making payments under the plan and rescind any written documents. Also, any reimbursements made after 2013 should be classified as taxable wages.

ACCEPTABLE ALTERNATIVES

Because of the ACA market reform requirements, employers are basically precluded from subsidizing or reimbursing employees for individual health insurance policies if there is more than one employee participating in the plan. Employers can, however, continue to do the any of the following:

- Provide a tax-free fringe benefit by purchasing an ACA-approved employer-sponsored group health plan. Small employers with 50 or fewer employees can provide a group health plan through the Small Business Health Options Plan (SHOP) Marketplace. A cafeteria plan can be set up for pre-tax funding of the employee portion of the premium.
- Increase the employee's taxable wages to provide funds that the employee may use to pay for individual insurance policies. However, the employer cannot require that the funds be used to pay for insurance—it must be the employee's decision to do so (or not). The employer can claim a deduction for the wages paid. The wages are taxable to the employee, but the employee can claim the premiums as an itemized deduction subject to the 10%-of-AGI limit (7.5% if age 65 or older).

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

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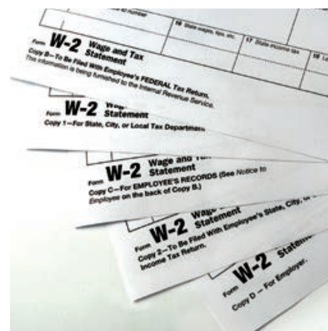
WHAT TO DO IF YOU DON'T GET A FORM W-2

If you worked as an employee during 2014, your employer must give you a Form W-2, Wage and Tax Statement, by February 2, 2015. This form shows the amount of wages you received for the year and the taxes withheld from those wages and it must be filed with your return.

If you haven't received yours by mid-February, you should first ask your employer to give you a copy of your Form W-2. If the employer mails the form to you, be sure they have the correct address.

If you exhaust the options with your employer and you still have not received the Form W-2, call the IRS at 800-829-1040. Have the following available when you call:

- Your name, address, Social Security number, and phone number.
- The employer's name, address, and phone number.
- The dates you worked for the employer.
- An estimate of the amount of wages paid and federal income tax withheld in 2014. If possible, use your final pay stub to figure these amounts.



Your tax return is due by April 15, 2015. If you don't get your Form W-2 in time to file, we usually recommend extending your return for six months. However, you can use Form 4852, Substitute for Form W-2, Wage and Tax Statement, to file your return by April 15. You will need to estimate your wages and withheld taxes and the IRS may delay processing your return while it verifies the information. Also, an amended tax return may need to be filed if you receive the missing Form W-2 after you file and the tax information on the form is different from what you originally reported on your Forms 4852 and 1040. ■

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