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CERTIFIED PUBLIC ACCOUNTANTS | CONSULTANTS   CLIENT PLANNING ADVISORY   FALL 2014

WELCOME!

Atkinson & Co. is glad to announce that on November 1, 2014, Matts & Co. Accounting Professionals, LLC joined our firm. Jared Matts, CPA, Brenda Tyrrell, Lee Brinckerhoff, Leah Szczesiul, and Christina Holcomb joined us.

We welcome you all to Atkinson & Co.!

Jared Matts, CPA
Tax Director/Shareholder

Year-End Family Tax Planning

Besides donating appreciated securities to charity, another solution for avoiding highly taxed capital gains on these securities is to transfer the relevant assets to a family member in a lower tax bracket. The recipient might be able to sell and pay little or no tax on the sale.

Example: Grace Fulton invested $10,000 in ABC Corp. shares years ago. The shares are now worth $18,000; Grace fears the trading price of ABC will drop, so she'd like to sell the shares. However, Grace will face a significant tax bill if she takes an $8,000 long-term capital gain.

Therefore, Grace gives the shares to her son Eric, who sells them. Grace's basis in the shares ($10,000) and her holding period (longer than a year) carry over to Eric, so he reports an $8,000 long-term capital gain. As long as Eric will owe less tax on a sale than Grace would have owed, the Fulton family will come out ahead.

REAL PROBLEMS

This scenario can work in real life, but there are some issues to keep in mind. For one, gifts over $14,000 to any one recipient in 2014 may trigger the requirement to file a gift tax return. There may not be any gift tax owed, due to a $5.34 million lifetime gift tax exemption, but there can be paperwork requirements and the potential loss of estate tax benefits.

Moreover, the so-called kiddie tax limits the advantage of transferring assets to youngsters before a sale. In 2014, "kiddies" are taxed at their own tax rate on their first $2,000 of unearned income and generally owe little or no tax on the income. Beyond that $2,000, though, unearned income is taxed at the parent's rate. Thus, if Eric Fulton has an $8,000 long-term gain from a stock sale and no other unearned income in 2014, $2,000 would get favorable tax treatment, but the other $6,000 would be taxed at his mother Grace's rate.

The key question, then, relates to which youngsters are considered kiddies. Generally, that includes children 18 or younger. Kiddie tax status persists until age 24 for full-time students who provide less than half of their own support. ❍

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Year-End Charitable Tax Planning

Donating appreciated assets (including securities) can be a thoughtful tactic for people who can't offset capital gains with capital losses.

Example 1: Lynn Knight invested $8,000 in an aggressive stock fund in 2009. The shares are now worth $20,000, thanks to some excellent selections, but Lynn believes it is time to take her gains. Selling the shares would generate a $12,000 long-term capital gain, costing Lynn thousands of dollars in tax.

In our scenario, Lynn has no old or new capital losses she can use to offset her gains. She does have a commitment to donate $10,000 each year to her alma mater. Therefore, she donates her $20,000 of fund shares in December 2014, notifying the school that she is making her contributions for 2014 and 2015.

With this maneuver, Lynn receives a $20,000 charitable tax deduction for 2014 while avoiding tax on the disposition of the appreciated shares. Meanwhile, the $20,000 she would have sent to the college is still in Lynn's bank account, so she can use the money to reinvest in assets she believes have investment appeal now.

SIMPLE STRATEGY

The method described here probably will work well for a single $20,000 donation of appreciated securities, as described. All Lynn has to do is get the appropriate account number from her alma mater and notify the fund company to make the transfer by year-end, for a 2014 deduction.

Things would be different, though, if Lynn wanted to make a $1,000 charitable contribution to 20 different charities. To use her appreciated fund shares, she would have to deal with a huge amount of paperwork, getting the information from each charity and forwarding it to the fund company. In such a situation, you can use a donor advised fund (DAF) to handle multiple transfers with ease. Many financial firms and community foundations offer a DAF.

Example 2: Intending to make multiple donations, Lynn has the fund company transfer her $20,000 worth of shares to a DAF she has specified. If she acts by year-end, Lynn will get the $20,000 tax deduction for 2014, she'll avoid capital gains tax and she'll have cash in the bank to reinvest.

After the transfer, the DAF can sell the shares and put the $20,000 into Lynn's account. Then Lynn (the donor) can advise the fund to send $1,000 to Charity A, $1,000 to Charity B, and so on. Even if this process runs into 2015 and future years, Lynn won't lose her 2014 charitable tax deduction. ❍

S Corporation or LLC?

Many business owners structure their companies as S corporations or limited liability companies (LLCs). On the surface there are several similarities. Both types of entities avoid corporate income tax. Instead, business income is taxed only once, on the tax return of the S corporation shareholder or the LLC member. Moreover, both S corporation shareholders and LLC members have limited liability: their financial exposure from the company's operation generally is no greater than the amount they invest and any notes they personally sign. (In exceptional circumstances, creditors may gain access to additional personal assets of the business owner.)

Nevertheless, there are differences between the two structures, which you should consider when choosing between them.

LOOKING INTO LLCS

In some ways, an LLC resembles a sole proprietorship or a partnership, but with the advantage of limited liability. Usually, you can form an LLC with relatively little paperwork. Once an LLC is operating, there may be few tax returns to file and other recordkeeping and reporting requirements for LLCs are generally less burdensome than for corporations. If an LLC has multiple members, the business has a great deal of flexibility in how any profits are distributed among them.

A downside is that an LLC may have a limited life. Depending on state law and the operating agreement, the death of a member may dissolve the LLC, for instance. In addition, taxes might be relatively high for LLC members. That's because the net income of the LLC can be passed through to members as earned income on their personal tax returns. The members can be treated as if they were self-employed; they owe the employer and employee shares of items such as Social Security and Medicare tax, with a relatively small deduction as an offset.

CONSIDERING S CORPS

Even after making an election to be taxed under Subchapter S of the Internal Revenue Code, an S corporation is still a corporation. There are meetings that must be held, minutes that must be kept, and extensive paperwork to process. Such efforts can be time consuming and expensive.

In addition, S corporations must meet certain requirements. A business with more than one class of stock or a shareholder who is not a U.S. citizen or resident can't be an S corporation, for example. Similarly, an S corporation can't make disproportionate distributions of dividends or losses.

On the plus side, S corporation shareholders can receive a salary, on which they owe payroll tax, and dividends, on which they don't. Although artificially low-balling a salary will draw the ire of the IRS, S corporation owners may pay thousands of dollars less per year in payroll taxes than LLC members pay on similar company related income. What's more, S corporations can be long-lived, and this permanent nature may make them more attractive to lenders and investors than potentially short-lived LLCs.

CHOOSING OR COMBINING

Your choice of business structure may come down to whether you prefer the simplicity and flexibility of an LLC or the potential tax savings and lender and investor appeal of an S corporation. State laws vary, so a tilt in one direction or another may influence your decision.

Yet another possibility is to set up your business as an LLC and then request S corporation taxation by filing IRS Form 2553, "Election By A Small Business Corporation." Our office can go over your specific circumstances to help you decide how to structure your company. ❍

Year-End Retirement Tax Planning

One reliable way to reduce the impact of higher tax rates, surtaxes, phaseouts and so on is to make tax deductible contributions to retirement plans. In 2014, the maximum salary (and tax) deferral for 401(k) and similar plans is $17,500, or $23,000 if you are 50 or older. If you are not maximizing such contributions already, consider increasing the amount by year-end.

Business owners, professionals, and self-employed individuals may be able to make even larger deductible contributions to retirement plans. Often, the deadline to create such a plan for the year is December 31, even though the actual contributions may be deferred for several months. Our office can help you determine which type of plan would be best for you and your employees.

REFINING ROTH IRAS

The end of the year is often a good time to convert a traditional IRA to a Roth IRA. All Roth IRA distributions are tax-free after five years, if you are at least age 59½. What's more, the five year clock starts on January 1 of the conversion year. Thus, a December 2014 conversion will have a January 1, 2014, start date for this purpose and reach the five-year mark on January 1, 2019, just over four years from now.

The downside of a Roth IRA conversion is that you must pay income tax on all pretax dollars you move from your traditional IRA to a Roth IRA. Converting can be extremely taxing.

Example 1: Diane Carson is a single taxpayer with $150,000 of taxable income in 2014, before any Roth IRA conversion. If Diane converts her traditional IRA, which contains $250,000 in pretax dollars, to a Roth IRA, she will report $400,000 of taxable income on her tax return. The added income will be taxed mostly at a 33% rate so Diane will owe more than $80,000 in tax on the conversion.

In this example, Diane has an excellent idea of what her taxable income will be for 2014. Her $150,000 of taxable income puts her in the 28% tax bracket, which goes up to $186,350 for single filers this year. Thus, Diane decides to convert $35,000 of her Roth IRA in 2014. She'll owe $9,800 in tax on the conversion (28% of $35,000), which she can pay with non-IRA funds. Over time, a series of such partial conversions can build up Diane's Roth IRA so that it can become a valuable source of tax-free retirement income.

Suppose, though, that Diane's taxable income varies from year to year. In that case, she might do a much larger Roth IRA conversion. A conversion in 2014 can be recharacterized (reversed) back to a traditional IRA, in whole or in part, until October 15, 2015.

Example 2: Diane converts $100,000 of her traditional IRA to a Roth IRA in 2014. When she has her tax return prepared in April 2015, Diane learns that her taxable income would be $166,350, without any income from the Roth IRA conversion.

As mentioned, the 28% tax bracket for a single filer goes up to $186,350 in 2014. Therefore, Diane can add $20,000 to her taxable income for the year, still taxed at 28%. Diane recharacterizes enough of her Roth IRA conversion to leave her with a $20,000 Roth IRA conversion, in the 28% bracket. She can repeat this process every year, building up her Roth IRA at a relatively low tax cost. ❍

IRS Repeats Warning About Phone Scams

WASHINGTON — The Internal Revenue Service issued a consumer alert providing taxpayers with additional tips to protect themselves from telephone scam artists calling and pretending to be with the IRS.

These callers may demand money or may say you have a refund due and try to trick you into sharing private information. These con artists can sound convincing when they call. They may know a lot about you, and they usually alter the caller ID to make it look like the IRS is calling. They use fake names and bogus IRS identification badge numbers. If you don't answer, they often leave an "urgent" callback request.

"These telephone scams are being seen in every part of the country, and we urge people not to be deceived by these threatening phone calls," IRS Commissioner John Koskinen said. "We have formal processes in place for people with tax issues. The IRS respects taxpayer rights, and these angry, shake-down calls are not how we do business."

The IRS reminds people that they can know pretty easily when a supposed IRS caller is a fake. Here are five things the scammers often do but the IRS will not do. Any one of these five things is a tell-tale sign of a scam. The IRS will never:

1. Call you about taxes you owe without first mailing you an official notice.
2. Demand that you pay taxes without giving you the opportunity to question or appeal the amount they say you owe.
3. Require you to use a specific payment method for your taxes, such as a prepaid debit card.
4. Ask for credit or debit card numbers over the phone.
5. Threaten to bring in local police or other law-enforcement groups to have you arrested for not paying.

If you get a phone call from someone claiming to be from the IRS and asking for money, here's what you should do:

- If you know you owe taxes or think you might owe, call the IRS at 1.800.829.1040. The IRS workers can help you with a payment issue.
- If you know you don't owe taxes or have no reason to believe that you do, report the incident to the Treasury Inspector General for Tax Administration (TIGTA) at 1.800.366.4484 or at www.tigta.gov.
- You can file a complaint using the FTC Complaint Assistant; choose "Other" and then "Imposter Scams." If the complaint involves someone impersonating the IRS, include the words "IRS Telephone Scam" in the notes.

Remember, too, the IRS does not use unsolicited email, text messages or any social media to discuss your personal tax issue. For more information on reporting tax scams, go to www.irs.gov and type "scam" in the search box.

Additional information about tax scams are available on IRS social media sites, including YouTube and Tumblr where people can search "scam" to find all the scam-related posts. ❍

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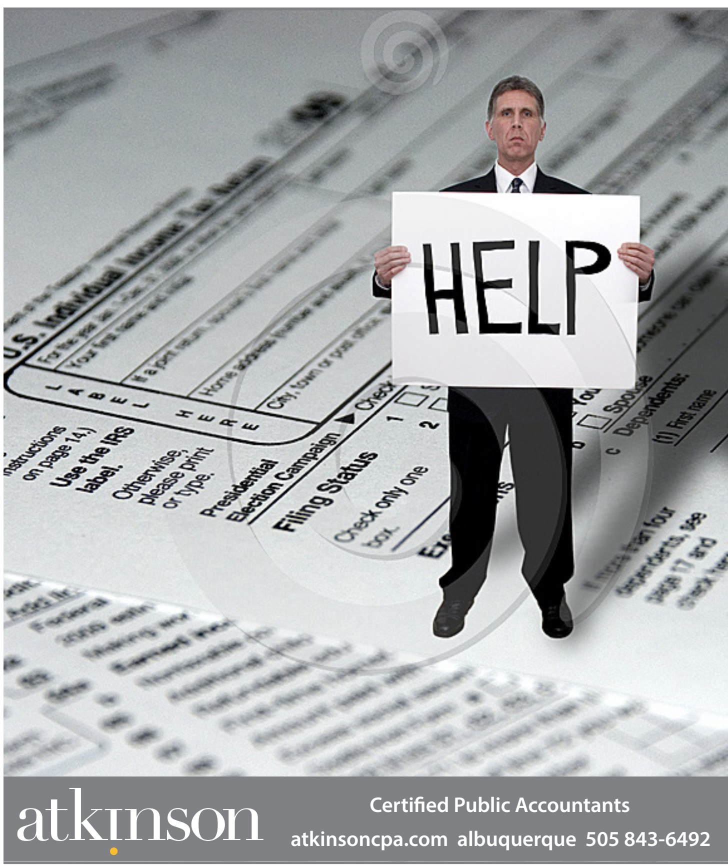

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