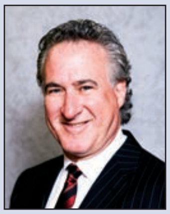
Meisel, Tuteur & Lewis, P.C.
Certified Public Accountants
Management Consultants

Thoughts from Outside the Box
OUR PERSPECTIVES

1st Quarter 2014 Volume 13 Issue 1



Dear Clients and Friends,

2014 has started out as a year of ups and downs. Here in the Northeast, we have experienced record amounts of snow, causing much havoc and disruption as well as tremendous costs in heating, snow plowing, fuel and lost business production. The stock market dropped in January only to return to almost record highs in February. Real estate prices have risen in areas that were depressed in the last few years and mortgage rates have remained low.

The budget and debt ceiling fixes passed in October 2013 were scheduled to expire this February. So, on February 11, a divided House and Senate voted to let our government borrow enough money to pay its bills for the next year, with a new expiration date of March 15, 2015. This increases the debt ceiling to roughly $17.2 trillion without imposing any deficit-reduction provisions. Unfortunately, this band-aid strategy offers no real long-term solution to our country's economic challenges.

Here at the firm, we are in the middle of busy season, and everyone is working diligently to meet regulatory deadlines. We are here to service your needs and are available anytime to answer questions. Please do not hesitate to call.

Stay warm and safe this winter. Hopefully it's almost over.

Very truly yours,
Michael S. Lewis, CPA
Managing Partner

Is Your Business Ready for 2014?

2013 was a mixed bag of experiences for many businesses. Like many owners, you may have reviewed your financial information to determine how you did and where improvements might be needed. You probably also set new goals or recommitted to old ones. But do you have an action plan to get you there? One that is measurable and attainable?

To help, we've put together a self-assessment guide to help you determine how your business is performing and if you are properly positioned for success in 2014. We encourage you to consider the points outlined in this article, and break your action plans into monthly goals, not just annual ones. Look at every 30-day chunk of time as an opportunity to reassess your business and progress. This strategy will encourage you to create more manageable and measurable action plans.

Begin by answering these questions:

- What were your successes in 2013?
- What left you feeling disappointed?
- Did you grow as much as you hoped?
- Did you lose business? Why?
- Could you have improved your marketing?
- Was your cash flow sufficient to cover all your necessary and desired expenses?

Next, write down your goals for 2014.

Now, evaluate the five areas below for improvement and cost-saving opportunities.

1. **Profitability.** Knowing your bottom line isn't enough. To sustain profitability over the long-term, you must also understand where the profits are coming from and where the weaknesses lie. How much time and money are you spending to deliver your product or service for every dollar of revenue that you generate? Is this ratio sustainable and profitable? If not, evaluate your research and development, training, and labor costs, as well as market demand and benchmarking studies, to determine if your pricing strategy is in line with your competition.

2. **Cash flow.** Do you have a solid handle on your cash flow? Not how much you are owed or even what you have in the bank, but how much is available to you to pay bills or invest back into the business. It's critical to maintain positive cash flow at all times to remain healthy, but this may not always be feasible. In that case, it's critical to have resources that you can tap into to get you through the slow times. The good news is that many lending institutions are opening their doors to small businesses needing

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Inside this Issue

Tips for Substantiating Income and Deductions

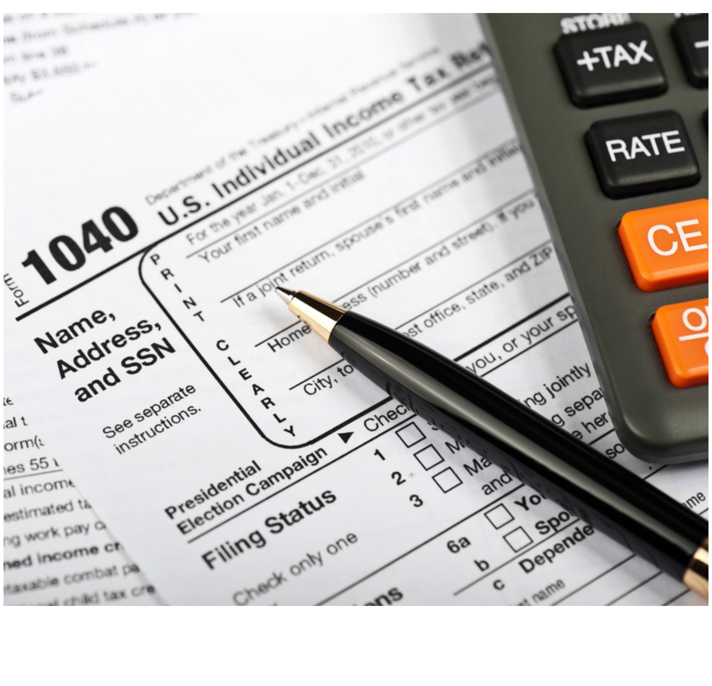
Shane Orbach, CPA, MST

Each year, taxpayers spend countless hours gathering information and documentation that will be necessary to prepare tax returns and substantiate claims for deductions and credits. Good record keeping can make this tedious task easier, especially as the Internal Revenue Service (IRS) becomes more stringent with their requirements. Should a taxpayer be selected for an audit, this preparation becomes particularly important as without proper documentation, taxpayers may be denied deductions and even become subject to penalties.

Generally, taxpayers receive a variety of forms from third parties that supply them with information they in turn report on their Form 1040 (U.S. Individual Income Tax Return). These forms include, but are not limited to: W-2 (wages), 1099-INT (interest), 1099-DIV (dividends), 1099-SSA (social security), and 1098 (mortgage interest). It's important to note that copies of these forms are also sent to the IRS. Consequently, using social security numbers and sophisticated software, the IRS matches the information reported to them by third parties with the information reported on the taxpayer's income tax return. For this reason, it's critical that taxpayers ensure all income and deduction amounts reported by third parties are correct, match the filed Form 1040, and that social security numbers are reflected accurately on all forms received. If there is an error, it is essential to contact the third party and have them correct and resubmit the form, prior to filing one's return.

Below is some guidance on how to substantiate various common exclusions, deductions and credit items.

Capital Gains as a Result of Home Sale. For those filing 'Married Filing Jointly,' up to $500,000 of gain from the sale of a principal residence may be excludable from gross income



($250,000 if filing as 'Single'). To qualify for the exclusion, during the five-year period that ends on the sale date, the individual must have owned and used the property as a principal residence for periods aggregating two or more years (730 days). In addition, this exclusion may only be used once every two years. However, if the sale of a home produces a gain in excess of the allowable exclusion or the property was not used as one's principal residence, copies of both the purchase and sale documents must be presented, as well as invoices for any improvements that may have been done during ownership, in order to establish basis. Without basis documentation, upon audit, the IRS will assume the gain is the entire selling price.

IRA Contributions and Distributions. Precise record keeping related to contributions and distributions from Individual Retirement Accounts (IRAs) can save taxpayers significant money. The tax treatment of contributions and distributions can be very different depending on a number of factors, including: the type of IRA, the amount of tax-deferred contributions made, and how long the IRA was funded prior to distribution, among other criteria. If adequate records are not maintained, the IRS may take the position that all distributions are fully taxable and all contributions are non-deductible.

Charitable Contributions. One area highly targeted by the IRS is deductions related to charitable contributions. The type of contribution—cash vs. non-cash—and the value of the contribution, dictates how much and what type of documentation is required to substantiate the donation. For more detailed information on these requirements, read Katie Bewalder's article beginning on Insert 1.

Mortgage Interest Expense. The Interest paid on a loan secured by a primary residence or second home is generally considered an itemized deduction on Form 1040, Schedule A. In order to receive the deduction the taxpayer must (a) be the primary borrower, (b) be legally obligated to pay the debt, and (c) must actually make the payments. For example, if a parent pays their son's mortgage payments each month, they will not be entitled to the interest deduction since they were not legally obligated to pay the debt. Nor will the son be entitled to the deduction because he did not actually make the payments. A second issue that arises in this area is the limitation to the amount which may be deducted. The mortgage interest deduction is limited to the interest paid on acquisition debt of no more than $1 million. Acquisition debt is defined as a mortgage used to buy, construct, or improve a home. Taxpayers can also deduct interest on home equity debt of up to $100,000, regardless of how the loan proceeds are used.

Real Estate Tax. Unlike mortgage interest, the real estate tax deduction is not limited to the primary residence plus one other. However, like the mortgage interest deduction, the taxpayer claiming the deduction must be legally obligated to pay the debt and actually be the one making the payments. Thus, a taxpayer is entitled to receive a deduction for all real estate taxes paid on any number of properties owned.

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Hiring Your Children May Yield Tax Benefits and More

Anthony Pentz, CPA, MST

Between the frigid air of the polar vortex and the seemingly endless amounts of snow we have received, I cannot help but look ahead to the summer and a tax planning opportunity that it presents. When your kids are home from school, consider hiring them in your family business. In addition to providing valuable work experience, hiring your child as a bona fide employee can provide numerous ways to save tax dollars while keeping business income in your family.

Income Shifting

By paying wages to your child, you create business deductions that reduce your taxable income. Obviously this is income to your child, but in addition to it being partially tax-free, the portion that is taxed will likely be at a lower rate than if it were left in the business and taxed to the parent.

Consider this scenario: In 2014, your child can claim a deduction of $6,200, meaning there is no federal income tax on the first $6,200 earned. Additional dollars are taxed at the appropriate tax bracket, the lowest of which is 10% on taxable income, up to $9,075. Therefore, in this example, if your child earns $15,275, they would owe $908 of federal income tax. Presuming the parent is in the highest tax bracket (39.6%), tax on the same $15,275 taken by the parent would result in federal income tax of $6,049, a difference of $5,141 in federal tax. In addition, if your child is under the age of 18 and your business is structured as a sole proprietorship, single member LLC or a husband-wife partnership, the wages you pay your child are exempt from Social Security, Medicare, and Federal Unemployment taxes. This can result in an additional savings of roughly 3% of the wages paid.

Additional Benefits

Depending on your individual situation, additional benefits can present themselves when you hire your child. For example, credits related to payments for higher education tuition and related expenses (American Opportunity Tax Credit) are completely phased out for married couples with adjusted gross income in excess of $180,000. If, however, you do not take the student as a dependent then the student may claim the education credit on his or her return. In many cases this results in an overall tax savings for the entire family.

Another potential planning area involves retirement plan savings. When planned correctly, your child may be able to make deductible contributions into a traditional IRA account, potentially sheltering up to an additional $5,500 from taxation, or contribute to a Roth IRA, benefiting from tax-free growth. If they work enough hours, they may even be eligible to participate in the company's 401k or profit-sharing plans.

As you can see, there are numerous financial and intangible reasons to hire your children in the family business. Of course, please keep in mind that if you choose to do so, the work performed and salaries paid must be reasonable with a bona fide business purpose. As always, please reach out to your trusted professional at Meisel, Tuteur & Lewis should you wish to explore this idea further. ■

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Tips for Substantiating Income and Deductions

Business Expenses. Self-employed individuals who report their income and expenses on Form 1040, Schedule C, as well as entities reporting on separate business returns, have similar issues related to record keeping and substantiation of expenses. In order to verify income items, the IRS often analyzes third party information as discussed above, in addition to a taxpayer's internal records and banking information. Any funds deposited into bank accounts in excess of income reported on tax filings will be closely reviewed for non-reporting issues. Further, it's essential to make sure the information reflected on different types of tax returns (i.e., sales tax and employment tax) all match. Businesses are permitted to deduct from gross income business expenses deemed to be "ordinary and necessary" so long as they can be substantiated. This requires proof of the amount paid and evidence establishing the business nature of the expense. Valid proofs of payment include cancelled checks, credit card statements, bank statements, signed invoices, and cash payment receipts from vendors, so long as they provide a general description of the transaction as well as the date, time, and location. For meals and entertainment expenses, the IRS has stricter substantiation requirements. In addition to proving the amount, time, location, and business purpose of the expenditure, taxpayers must also substantiate the relationship of all participants.

With so many requirements, setting up good record keeping procedures and making it an ongoing priority can clearly save you substantial time and money in the future. Should you need further clarification on anything, do not hesitate to contact your MT&L tax professional. ■

An Inside Look

Employee News

Congratulations to **Tom Wargacki** on his engagement to Julie Ann Mulcahy. A May 2015 wedding is being planned.

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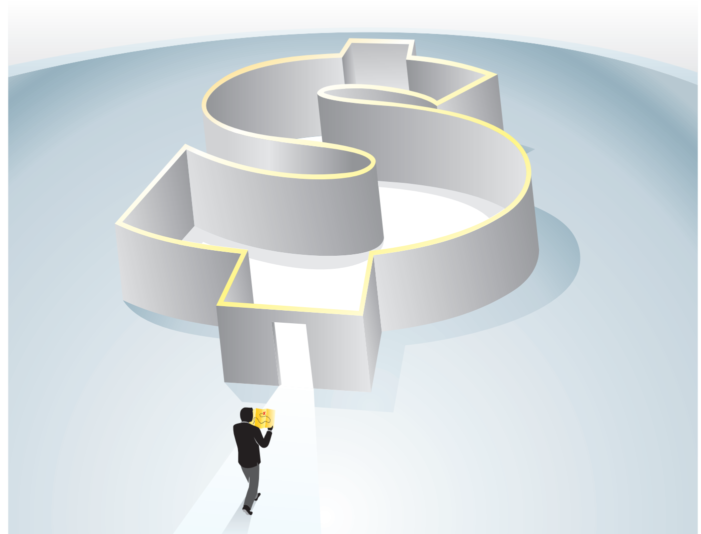
Is Your Business Ready for 2014?

affordable business loans and credit lines. In addition, we may be able to help you implement strategies that will help you collect money faster, improving positive cash flow.

3. Expenses. It's impossible to eliminate all of your expenses, but there are things that can often be renegotiated, such as:

- **Insurance Premiums.** Things change year to year, potentially impacting how much insurance you need. Review your coverage to ensure it is accurate and up-to-date. Then challenge your insurance agent to find you the most competitive rates available.
- **Labor Costs.** Are you paying full-time employees even when workflow is light? Are you feeling stressed by the high cost of payroll taxes, benefit packages, and training? Consider hiring interns or outsourcing work to freelancers or contractors.
- **Paper Costs.** Are you still printing reams of letterhead and envelopes, only to discover that 90% of the time you email all of your correspondence? Create digital versions of your letterhead that can be printed in-house. You'll print less, store less, waste less, and save more.
- **Storage Costs.** Investing in cloud storage solutions is a great long-term plan to reduce and even eliminate that wall of file cabinets, off-site storage costs (along with the exorbitant amount of time it takes to box everything up and then unbox it when it's needed), and shredding costs.
- **Interest Rates.** Credit card companies and banks want your business. Negotiate for a lower APR on all your credit cards and credit lines.
- **Cost of Goods Sold.** Rarely is your current supplier the *only* supplier. Negotiate with them for lower prices or better terms.
- **Travel Costs.** Is it really necessary for you and your team to travel as much as they do? Consider leveraging online meeting tools like Skype and web meeting applications.

4. Risk Assessment. Owners and executives should "hope for the best but prepare for the worst." With that in mind, conduct a



risk assessment to see what dangers exist within your business, what the impact may be and what strategies can be put into place to prevent or mitigate them. Dangers can range from natural disasters (e.g., Hurricane Sandy) to man-made problems (e.g., fraud or unexpected resignations).

5. Evaluate your supply chain. Do you rely on outside vendors for any part of your process? What would happen if they couldn't deliver?

Finally, write down your action plans, keeping timelines manageable and achievable. For example, are you committed to increasing business by 20% this year? Aim for 1–2% growth each month to determine if you are on track.

With so many business improvement opportunities available, it can be overwhelming. The advisory team at Meisel, Tuteur & Lewis is always available to help you evaluate your opportunities. ■

> *"You have to learn the rules of the game. And then you have to play better than anyone else."*
>
> \- Albert Einstein

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Tax Update

William Schwarz, CPA, MST

- **FACTA Applications.** Foreign Financial Institutions (FFIs) required to register under the Foreign Account Tax Compliance Act (FACTA) may now finalize and submit their FACTA applications through the IRS on-line registration system. Under FACTA, an FFI must file an application and obtain a Global Intermediary Identification Number (GIIN) or face new U.S. tax withholding requirements on payments made from the U.S. The IRS expects to post a list of registered FFIs who have obtained a GIIN by June 2, 2014. In order to ensure inclusion on the initial IRS FFI list applicants need to finalize their registration applications by April 25, 2014. An FFI may also register on paper by filing Form 8957, but this is not recommended.

- **PFIC Owner Filing Requirements.** The IRS has issued new regulations that provide guidance on determining ownership of a Passive Foreign Investment Company (PFIC) and the annual filing requirements for shareholders of PFICs. A PFIC is any foreign corporation where at least 75% of its gross income is passive, or at least 50% of its assets produce passive income or are held for the production of passive income. Shareholders of PFICs are required to file Form 8621 annually with their tax return to disclose the ownership, make any applicable elections related to the PFIC, and potentially report income from the PFIC. Owners of PFICs should review their annual filings to ensure they are compliant with the new regulations.

- **Standard Mileage Rates for 2014.** Effective January 1, 2014, the optional mileage allowance for owned or leased autos has decreased by 0.5¢ to 56¢ per mile for business travel conducted in 2014. In addition, the rate for using a car to get medical care or in connection with a move that qualifies for the moving expense deduction has also decreased by 0.5¢ to 23.5¢ per mile.

- **Bankruptcy Protection for Inherited IRAs.** The Supreme Court has agreed to consider whether bankruptcy protection should apply to inherited IRAs. Currently, there is a conflict among some lower courts as to whether a debtor's inherited IRA qualifies for an exemption under the bankruptcy laws. The question to be answered is whether or not inherited IRAs are "held for retirement" of the debtor. We will continue to monitor this case and keep you updated on its progress. ■

Know the Requirements Before You Donate

Katie Bewalder, CPA

Most taxpayers are familiar with the benefit of deducting charitable contributions on their tax return. However, many are not aware of how strict the Internal Revenue Service (IRS) has become when it comes to substantiating those deductions. In fact, there have been numerous cases of taxpayers being denied deductions because of failure to provide the required information. To assist you with future record keeping, here is an overview of the documentation you must provide to the IRS for all charitable contributions you make, both cash and non-cash.

Cash contributions of less than $250

When donating less than $250 in cash to a charity, taxpayers need only retain a bank record, such as a cancelled check or a written acknowledgement from the charitable organization that includes the organization's name and the date and amount of the donation. The written receipt must be received no later than the date the tax return is filed or the due date of the tax return, whichever is later.

Cash contributions of $250 or more

More thorough substantiation rules apply to cash contributions of $250 or more. In this case, a taxpayer must obtain a written acknowledgement from the charitable organization that includes

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Know the Requirements Before You Donate

the organization's name, the date and amount of the donation, a statement indicating whether any goods or services were provided in exchange for the donation, and the value of those goods or services, if provided. Donations are not aggregated for the purpose of this requirement.

Non-cash contributions of less than $500

Requirements for non-cash contributions valued at less than $500 are similar to those of cash contributions. A taxpayer must obtain a written acknowledgement from the charity that includes the organization's name, the date and location of the contribution, and a detailed description of the property donated. If the donation is valued at $250 or more, the receipt must also indicate whether any goods or services were provided in exchange for the donation and the value of those goods or services. In addition, the taxpayer must maintain records of the fair market value at the time of the gift, how the fair market value was determined, and the taxpayer's original cost. It is very important that the receipt includes a detailed description of the items.

Non-cash contributions in excess of $500 but not more than $5,000

In addition to the items required above, Form 8283 must be completed and included with the income tax return when filed. This form provides the IRS with additional information regarding the items donated, including the date of purchase and the method used to determine the fair market value used for the deduction. Taxpayers donating motor vehicles valued at more than $500 must also attach Copy B of Form 1098-C (Contributions of Motor Vehicles, Boats, and Airplanes), and Form 8283 to their tax returns. The description of the donated vehicle should include the vehicle's make, model, condition, and mileage.

Non-cash contributions in excess of $5,000

The IRS imposes greater responsibilities on taxpayers generous enough to make non-cash contributions of property valued at more than $5,000. In addition to a written acknowledgement from the charity, detailed records and Form 8283 as previously mentioned, a fully completed appraisal summary must be attached to the tax return for the year in which the deduction is first claimed. A qualified appraisal must be prepared no earlier than 60 days prior to the date of contribution of the property nor later than the due date of the return (including extensions), and must be prepared, signed and dated by a qualified appraiser. In addition, the appraisal must not involve a prohibited appraisal fee and must include specific information required by the IRS regulations, as follows:

- A detailed description allowing a person who is not generally familiar with the type of property donated to ascertain that the property appraised is indeed the property that was, or will be, contributed;
- The physical condition of the property;
- The date or expected date of the contribution;
- The terms of any agreement or understanding entered into regarding the use, sale or other disposition of the property contributed;
- The name, address and tax identification number of the appraiser;
- The qualification of the appraiser, including background, experience, education, and membership in any professional appraisal association;
- A statement that the appraisal was prepared for tax purposes;
- The date on which the property was appraised;
- The appraised fair market value of the property on the date or expected date of the contribution;
- The method or valuation used to determine the fair market value of the property; and
- The specific basis for the valuation, such as comparable sales, statistical sampling or other method.

Although the qualified appraisal is required to be retained by the taxpayer for as long as the taxpayer's return is subject to audit, for contributions under $500,000 only an appraisal summary consisting of the information listed on Section B of Form 8382 and signed by the qualified appraiser is required to be attached to the tax return. For contributions in excess of $500,000 and for art donations of $20,000 or more, a complete copy of the signed appraisal must be attached to the tax return.

The rules for contributions of publicly-traded securities in excess of $5,000 are a little different, as the fair market value is generally available from an established securities market. Therefore, an appraisal is not required unless the securities are governed by restrictions which materially affect the value of the securities or prevent them from being freely traded, or where the value that is claimed as a charitable deduction is different from the value listed in a market quotation from an established securities market.

Finally, all contributions of non-cash property are aggregated in determining whether the taxpayer's contributions exceed $5,000 in a given tax year, even where the items are donated to different charities.

The substantiation rules for the deductibility of charitable contributions of cash or property are more tedious than they are complex; but they absolutely must be adhered to in order to avoid your deductions being disallowed. If you have any questions, please don't hesitate to contact your MT&L advisor. ■