
# 2014 MIDYEAR TAX PLANNING

The ordinary federal income tax rates for 2014 will be the same as last year: 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%. For 2014, the top 39.6% rate affects taxpayers with taxable income above $406,750 for singles, $457,600 for married joint-filing couples, $432,200 for heads of households, and $228,800 for married individuals who file separate returns. Higher-income individuals can also be hit by the 0.9% Medicare tax and the 3.8% Net Investment Income Tax (NIIT), which can result in a higher-than-advertised federal tax rate for 2014.

Despite recent tax increases, the current federal income tax environment remains relatively favorable by historical standards. This letter presents some tax planning ideas to consider this summer while you have time to think. Some of the ideas may apply to you, some to family members, and others to your business.

### Leverage standard deduction by bunching deductible expenditures

Are your 2014 itemized deductions likely to be just under or just over the standard deduction amount? If so, consider the strategy of bunching together expenditures for itemized deduction items every other year, while claiming the standard deduction in the intervening years. The 2014 standard deduction is $12,400 for married joint filers, $6,200 for single filers, and $9,100 for heads of households.

For example, say you're a joint filer whose only itemized deductions are about $4,000 of annual property taxes and about $8,000 of home mortgage interest. If you prepay your 2014 property taxes by December 31 of this year, you could claim $16,000 of itemized deductions on your 2014 return ($4,000 of 2014 property taxes, plus another $4,000 for the 2015 property tax bill, plus the $8,000 of mortgage interest). Next year, you would only have the $8,000 of interest, but you could claim the standard deduction (it will probably be around $12,600 for 2015). Following this strategy will cut your taxable income by a meaningful amount over the two-year period (this year and next). You can repeat the drill all over again in future years. Examples of other deductible items that can be bunched together every other year to lower your taxes include charitable donations and state income tax payments.

### Take advantage of 0% rate on investment income

For 2014, the federal income tax rate on long-term capital gains and qualified dividends is 0% when those gains and dividends fall within the 10% or 15% federal income tax rate brackets. This will be the case to the extent your

*continued on page 3*

## IN THIS ISSUE

## Let us help with your ERP software and IT needs!

**Accounting software needs - analysis, selection, implementation, training and support**

**Manufacturing and distribution solutions**

**Third-party software integration**

**Creating meaningful management reports using Crystal Reports or FrX**

**Assessing your IT controls and practices**

**Reviewing your internal processes and controls for efficiency as well as fraud prevention practices**

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## GET CONNECTED!

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# 2014 CAN HUNGER CAMPAIGN

We are pleased to announce that this year's "Can Hunger" campaign was a huge success! Thanks to the generosity of our clients and friends, 104 food items and $1,685 in cash were donated during tax season. Shannon & Associates has matched this donation! In total, this means a contribution value of $3,578.

These donations all go to benefit the Kent Food Bank. We feel this is a small yet important step in providing for those in need in our community.

The Kent Food Bank is one of the larger food banks in South King County. They provide food, clothing and government commodities. The Kent Food Bank provides limited financial assistance for help with basic needs such as housing/shelter, utility bills and medicine. Assistance is also given to link individuals with needed resources in the community.

Their services are provided in a manner that build on an individual's strengths and encourage self-sufficiency.

Thank you so much for your help and participation in our successful campaign to "can hunger"!

*continued from page 1*

taxable income (including long-term capital gains and qualified dividends) does not exceed $73,800 for married joint-filing couples ($36,900 for singles). While your income may be too high, you may have children, grandchildren, or other loved ones who will be in the bottom two brackets. If so, consider giving them some appreciated stock or mutual fund shares that they can then sell and pay 0% tax on the resulting long-term gains. Gains will be long-term as long as your ownership period plus the gift recipient's ownership period (before he or she sells) equals at least a year and a day.

Giving away stocks that pay dividends is another tax-smart idea. As long as the dividends fall within the gift recipient's 10% or 15% rate bracket, they will be federal-income-tax-free.

**Warning**: If you give securities to someone who is under age 24, the Kiddie Tax rules could potentially cause some of the resulting capital gains and dividends to be taxed at the parent's higher rates instead of at the gift recipient's lower rates. That would defeat the purpose. Also, if you give away assets worth over $14,000 during 2014 to an individual, it will generally reduce your $5.34 million unified federal gift and estate tax exclusion. However, you and your spouse can together give away up to $28,000 without reducing your respective exclusions.

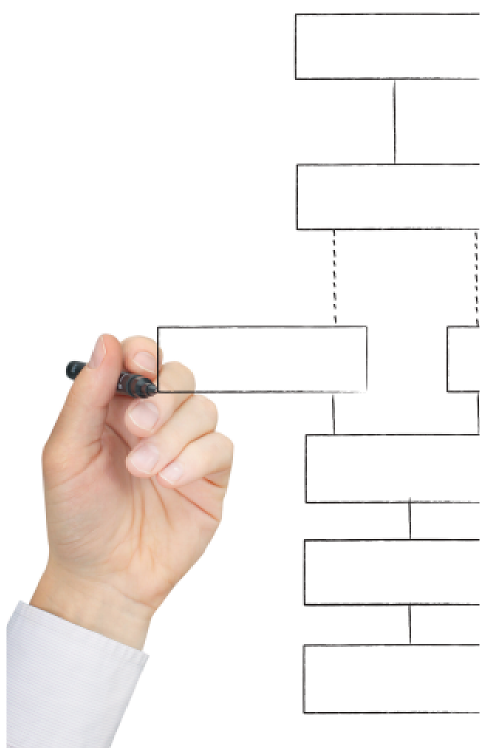
### Time investment gains and losses

For many other individuals, the 2014 federal tax rates on long-term capital gains will be 15%. However, the maximum rate for higher-income individuals is 20%. This 20% rate affects taxpayers with taxable income above $406,750 for singles, $457,600 for married joint-filing couples, $432,200 for heads of households, and $228,800 for married individuals who file separate returns. Higher-income individuals can also be hit by the new 3.8% NIIT on net investment income, which can result in a maximum 23.8% federal income tax rate on long-term capital gains.

As you evaluate investments held in your taxable brokerage firm accounts, consider the tax impact of selling appreciated securities (currently worth more than you paid for them). For most taxpayers, the federal income tax rate on long-term capital gains is still much lower than the rate on short-term gains. Therefore, it often makes sense to hold appreciated securities for at least a year and a day before selling in order to qualify for the lower long-term gain tax rate.

Biting the bullet and selling some loser securities (currently worth less than you paid for them) before year-end may be a good idea as well. The resulting capital losses will offset capital gains from other sales this year, including short-term gains from securities owned for one year or less. For 2014, the maximum rate on short-term gains is 39.6%, and the 3.8% NIIT may apply too, which can result in an effective rate of up to 43.4%. However, you don't have to worry about paying a high rate on short-term gains that can be sheltered with capital losses (you will pay 0% on gains that can be sheltered).

If capital losses for this year exceed capital gains, you will have a net capital loss for 2014. You can use that net capital loss to shelter up to $3,000 of this year's high-taxed ordinary income from salaries, bonuses, self-employment, and so forth ($1,500 if you're married and file separately). Any excess net capital loss is carried forward to next year.



Selling enough loser securities to create a bigger net capital loss that exceeds what you can use this year might make sense. You can carry forward the excess net capital loss to 2015 and beyond and use it to shelter both short-term gains and long-term gains recognized in those years.

### Consider deferring income

It may be beneficial to defer some taxable income from this year into next year, especially if you expect to be in a lower tax bracket in 2015 or affected by unfavorable phase-out rules that reduce or eliminate various tax breaks (child tax credit, education tax credits, and so forth) in 2014. By deferring income every other year, you may be able to take more advantage of these breaks every other year. For example, if you're in business for yourself and a cash-method taxpayer, you can postpone taxable income by waiting until late in the year to send out some client invoices. That way, you won't receive payment for them until early 2015. You can also postpone taxable income by accelerating some deductible business expenditures into this year. Both moves will defer taxable income from this year until next year.

### Invest in tax-free securities

The most obvious source of tax-free income is tax-exempt securities, either owned outright or through a mutual fund. Whether these provide a better return than the after-tax return on taxable investments depends on your tax bracket and the market interest rates for tax-exempt investments. With the additional layer of net investment income taxes on higher income taxpayers, this year might be a good time to compare the return on taxable and tax-exempt investments. In some cases, it may be as simple as transferring assets from a taxable to a tax-exempt fund.

### Make sure you qualify to exclude principal residence gain

Gains up to $500,000 on the sale of a principal residence are completely tax-free for married couples who file joint returns. A still-generous $250,000 is the limit for singles and married individuals

*continued on page 4*

*continued from page 3*

filing a separate return. To qualify for this break, you normally must have owned and used the house as your principal residence for a total of at least two years in the five-year period prior to the sale. You'll definitely want to take these rules into consideration if you're planning on selling your home.

### Sell loser shares and give away the resulting cash; give away winner shares

Say you want to make some gifts to favorite relatives and/or favorite charities. You can make gifts in conjunction with an overall revamping of your holdings of stocks and equity mutual fund shares held in taxable brokerage firm accounts. Here's how to get the best tax results from your generosity.

**Gifts to Relatives.** Do not give away loser shares (currently worth less than you paid for them). Instead, sell the shares and take advantage of the resulting capital losses. Then, give the cash sales proceeds to the relative. Do give away winner shares to relatives. Most likely, they will pay lower tax rates than you would pay if you sold the shares. In fact, relatives who are in the 10% or 15% federal income tax brackets will generally pay a 0% federal tax rate on long-term gains from shares that were held for over a year before being sold. For purposes of meeting the more-than-one-year rule for gifted shares, count your ownership period plus the recipient relative's ownership period, however brief. Even if the shares are held for one year or less before being sold, your relative will probably pay a lower tax rate than you (typically only 10% or 15%). However, beware of one thing before employing this give-away-winner-shares strategy. Gains recognized by a relative who is under age 24 may be taxed at his or her parent's higher rates under the so-called Kiddie Tax rules (contact us if you are concerned about this issue).

**Gifts to Charities.** The strategies for gifts to relatives work equally well for gifts to IRS-approved charities. Sell loser shares and claim the resulting tax-saving capital loss on your return. Then give the cash sales proceeds to the charity and claim the resulting charitable write-off (assuming you itemize deductions). This strategy results in a double tax benefit (tax-saving capital loss plus tax-saving charitable contribution deduction). With winner shares, give them away to charity instead of giving cash. Here's why. For publicly traded shares that you've owned over a year, your charitable deduction equals the full current market value at the time of the gift. Plus, when you give winner shares away, you walk away from the related capital gains tax. So, this idea is another double tax-saver (you avoid capital gains tax on the winner shares, and you get a tax-saving charitable contribution write-off). Because the charitable organization is tax-exempt, it can sell your donated shares without owing anything to the IRS.

### Watch out for alternative minimum tax

The alternative minimum tax (AMT) consequences of all tax planning strategies must be considered before actually making any moves. Because the AMT rules are complicated, you may want our assistance.

### Consider selling rather than trading-in vehicles used in business

Although a vehicle's value typically drops fairly rapidly, the tax rules limit the amount of annual depreciation that can be claimed on most cars and light trucks. Thus, when it's time to replace a vehicle used in your business, it's not unusual for its tax basis to be higher than its value. If you trade the vehicle in on a new one, the undepreciated basis of the old vehicle simply tacks onto the basis of the new one (even though this extra basis generally doesn't generate any additional current depreciation because of the annual depreciation limits). However, if you sell the old vehicle rather than trading it in, any excess of basis over the vehicle's value can be claimed as a deductible loss to the extent of your business use of the vehicle.

### Retirement plans

If your business doesn't offer a retirement plan, now might be the time to take the plunge. Current retirement plan rules allow for significant deductible contributions. Even if your business is only part-time or something you do on the side, contributing to a SEP-IRA or SIMPLE-IRA can enable you to reduce your current tax load while increasing your retirement savings. With a SEP-IRA, you generally can contribute up to 20% of your self-employment earnings, with a maximum contribution of $52,000 for 2014. A SIMPLE-IRA, on the other hand, allows you to set aside up to $12,000 for 2014 plus an employer match that could potentially be the same amount. In addition, if you're age 50 or older by year-end, you can contribute an additional $2,500 to a SIMPLE-IRA.

### Employ your child

If you are self-employed, you might want to consider employing your child to work in the business. Doing so has tax benefits in that it shifts income (which is not subject to the Kiddie tax) from you to your child, who normally is in a lower tax bracket or may avoid tax entirely due to the standard deduction. There can also be payroll tax savings since wages paid by sole proprietors to their children age 17 and younger are exempt from both social security and unemployment taxes. Employing your children has the added benefit of providing them with earned income, which enables them to contribute to an IRA. Children with IRAs, particularly Roth IRAs, have a great start on retirement savings since the compounded growth of the funds can be significant.

Remember a couple of things when employing your child. First, the wages paid must be reasonable given the child's age and work skills. Second, if the child is in college or entering soon, too much earned income can have a detrimental impact on the student's need-based financial aid eligibility.

### Don't overlook estate planning

For 2014, the unified federal gift and estate tax exemption is a historically generous $5.34 million, and the federal estate tax rate is a historically reasonable 40%. Even if you already have an estate plan, it may need updating to reflect the current estate and gift tax rules. You may need to make some changes for reasons that have nothing to do with taxes as well.

Additionally, it's a good time to review beneficiary designations on life insurance and retirement accounts. Changes may be needed if there have been family changes such as divorce, death of a current designated beneficiary, or the birth of a child.

### Conclusion

As we said at the beginning, this letter is to help you begin thinking about tax planning moves for the rest of this year. Please don't hesitate to contact us if you want more details or would like to schedule a tax planning strategy session.

# MAKING EXPENSE ACCOUNTS ACCOUNTABLE

Business owners who work for their company typically have expense accounts; the same usually is true for many employees. If your company has what the IRS calls an accountable plan, everyone can benefit from the tax treatment. The company gets a full deduction for its outlays (a 50% deduction for most dining and entertainment expenses,) while the employee reports no taxable compensation.

A company expense plan judged to be nonaccountable, on the other hand, won't be as welcome. It's true that the company can deduct 100% of the payments it makes for meals and entertainment, but it also will have to pay the employer's share of payroll taxes (FICA and FUTA) on the expense money paid to employees. The employees, meanwhile, will report those payments as wages, subject to income and payroll taxes.

In that situation, the employee can include employee business expenses (minus 50% of those for meals and entertainment) with other miscellaneous itemized deductions, but only miscellaneous deductions that exceed 2% of adjusted gross income can be subtracted on a tax return. Taxpayers who owe the alternative minimum tax can't get any benefit from their miscellaneous deductions.

### Key factors

In order for expense accounts to get favorable tax treatment, they should pass the following tests:

- **Business purpose.** There should be an apparent reason why the company stands to gain from this outlay. An employee might be going out of town to see a customer or a prospect, for example.
- **Verification**. Employees should submit a record of their expenses, in order to be reimbursed. Lodging expenses require a receipt, as do other items over $75.

In order to reduce the effort of dealing with multiple receipts, employers are allowed to give employees predetermined mileage and per diem travel allowances. Substantiation of other elements besides amounts spent (time, place, business purpose) is still required. If the amounts of those allowances don't exceed the amounts provided to federal employees, the process can be considered an accountable plan. (Excess allowance amounts are taxable wages.) Per diem rates can be found at www.gsa.gov/portal/category/104711.

**Example**: XYZ Corp. asks a marketing manager, Jill Matthews, to take a two-day business trip to Atlanta to demonstrate new products. The federal rate for Atlanta (lodging, meals and incidentals) on the federal per diem website is $189 per day. As required by the XYZ accountable plan, Jill accounts for the dates, place, and business purpose of the trip. XYZ reimburses Jill $189 a day ($378 total) for living expenses; her expenses in Atlanta are not more than $189 a day. In this situation, XYZ does not include any of the reimbursement on her Form W-2, and Jill does not deduct the expenses on her tax return.

- **Refunds.** Employees must return any amounts that were advanced or reimbursed if they were not spent on substantiated business activities.
- **Timeliness**. Substantiation and any required refunds should be made within a reasonable amount of time after the expense was incurred. Those times vary, but IRS publications indicate that substantiation should be made within 60 days, and any employee refunds should be made within 120 days.

For a plan to be accountable, reimbursements and allowances should be clearly identified. They can be paid to employees in separate checks. Alternatively, expense payments can be combined with wages if the distinction is noted on the check stub. Our office can help you check to see that your company's employee expense plan is accountable and, thus, qualifies for the resulting tax treatment.

# IRS SCAMS

IRS tax scams are on the rise. Therefore, it's important to use caution when viewing emails and receiving telephone calls purportedly from the IRS. Falling victim to a tax scam can be very costly, not only in money, but also in the amount of time and aggravations it can take to straighten out the resulting mess.

### Phone scams

The IRS has issued a warning about a pervasive phone scam. The Treasury Inspector General for Tax Administration (TIGTA) called it the largest scam of its kind. It has received reports of over 20,000 contacts related to this scam, and thousands of victims have paid over $1 million to fraudsters claiming to be from the IRS.

Potential victims are threatened with deportation, arrest, having their utilities shut off, or having their driver's licenses revoked. Callers are frequently insulting or hostile—apparently to scare their potential victims. Potential victims may be told they are entitled to big refunds, or that they owe money that must be paid immediately to the IRS. When unsuccessful the first time, sometimes phone scammers call back trying a new strategy.

Thieves who run this scam often:

- Use common names and fake IRS badge numbers.
- Know the last four digits of the victim's Social Security Number.
- Make caller ID appear as if the IRS is calling.
- Send bogus IRS emails to support the bogus calls.
- Make background noise of other calls being conducted to mimic a call site.
- Call a second time claiming to be the police or department of motor vehicles. The caller ID again appears to support their claim.

You should know that the IRS always sends taxpayers a written notification of any tax due via the U.S. mail. More importantly, the IRS will never ask for credit card, debit card, or prepaid card information over the telephone.

If you get a phone call from someone claiming to be from the IRS, and you think you owe taxes, hang up and call the IRS at (800) 829-1040 or, better yet, call us for help. If you don't owe taxes or have no reason to think you owe any taxes, hang up and call to report the incident to the Treasury Inspector General for Tax Administration at (800) 366-4484.

Anyone targeted by this scam, should also file a complaint with the Federal Trade Commission using the "FTC Complaint Assistant" at www.FTC.gov and adding "IRS Telephone Scam" to the comments portion of the complaint.

### Email scams

It is also important to be on the lookout for possible email scams that use the IRS as a lure. You should know that the IRS does not initiate contact with taxpayers by email to request personal or financial information. This includes any type of electronic communication, such as text messages and social media channels. The IRS also does not ask for PINs; passwords; or similar confidential access information for credit card, bank, or other financial accounts via email or any other means.

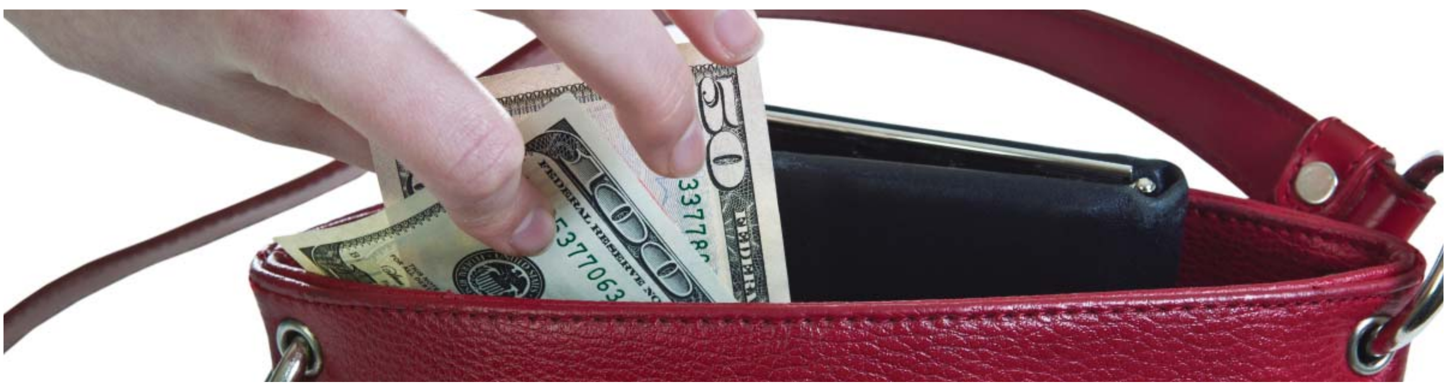
If you receive a suspicious email, do not open any attachments or click on any links contained in the message. Instead, forward the email to phishing@irs.gov.

### Conclusion

We hope this information will help keep you safe from potential IRS tax scams. If you have any questions or need additional information or any other assistance, please give us a call.

**Thank you for your referrals!**

**We appreciate the confidence you have in our services to recommend us to other individuals and businesses.**



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