Shannon & Associates LLP
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COMMITTED TO YOUR SUCCESS

Fall 2014

YEAR-END TAX PLANNING TIPS

As we enter the fall, the following are a few tax-saving strategies individuals and small businesses may want to consider to help lower their tax bill for 2014.

Individual tax planning

Fourth Quarter Estimated State Tax Payments. Taxpayers who itemize on their federal returns generally may deduct any state income taxes paid during 2014. Paying fourth quarter estimated state taxes (generally due in January) before the end of 2014 may reduce an individual's federal tax bill. However, potential alternative minimum tax consequences should be considered.

Retirement Savings. Employees enrolled in retirement savings plans may save taxes by increasing their pretax contributions before the end of the year. For 2014, employees may contribute up to $17,500 to their 401(k), 403(b), or 457(b) plan. If the plan permits, employees 50 and older may make an additional contribution of up to $5,500. (Additional plan limits may apply.)

For 2014, eligible taxpayers may make deductible contributions to an individual retirement account (IRA) of up to $5,500. Individuals 50 and older may contribute an additional $1,000. Even if a spouse has no earnings, he or she may still make an IRA contribution. However, the other spouse must earn enough to cover both contributions. An IRA deduction may be limited if the taxpayer (or the taxpayer's spouse) is an active participant in a retirement plan at work and adjusted gross income exceeds certain limits.

Required Minimum Distributions. Generally, individuals 70½ or older who have IRAs or retirement plan accounts must take their required minimum distributions (RMDs) before the end of the calendar year. Failure to do so may result in a 50% penalty on any required withdrawals not taken by that date.

Taxpayers who turn 70½ in 2014 may wait until April 1, 2015, to take their first RMD. However, a second RMD would also have to be taken in 2015 (by December 31) and, together, the two RMDs may substantially increase taxable income for 2015.

Higher Education Expense Credits. Those paying college-related expenses for their children will want to consider two potentially valuable tax credits: the American

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YEAR-END TAX PLANNING TIPS

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Opportunity Tax Credit (AOTC) and the Lifetime Learning Credit. Of the two, the AOTC is generally more beneficial for parents paying the undergraduate expenses of their children. This credit is worth up to $2,500 for eligible expenses of $4,000 or more (generally, tuition and fees, but not room and board).

Because the AOTC phases out for higher income taxpayers, it may be beneficial for the student to claim the credit on his or her own return. (Requirements apply.)

Also, taxpayers cannot “double dip” by claiming the AOTC for expenses paid with tax-free Section 529 college savings plan withdrawals. Those who have a 529 plan might want to pay some expenses out of pocket to preserve their right to use the credit.

3.8% NII Tax. Higher income taxpayers will have to pay an extra 3.8% surtax on the lesser of (1) net investment income (NII) or (2) the amount by which their modified adjusted gross income exceeds certain thresholds ($250,000 for joint filers or surviving spouses, $125,000 for those married and filing separately, and $200,000 for single and head-of-household filers). A number of strategies are available to help reduce NII, including transforming passive business activities into active business activities and deferring capital gains with installment sales.

Business tax planning

Expense Equipment Acquisitions. Owners who are planning a significant purchase for their business may want to do so before the end of the year. Section 179 of the tax code allows an immediate deduction of up to $25,000 for qualifying property placed in service by an active trade or business.

Qualifying property generally includes most depreciable property (other than buildings). In addition, the deduction limit is reduced dollar for dollar to the extent that the cost of qualifying property exceeds $200,000.

Plan for Profits and Losses. C corporation owners who expect to earn a profit this year may want to consider reducing their tax bill by paying bonuses or making a tax-deductible profit sharing contribution.

Likewise, S corporation owners may want to calculate how much they can contribute to the company’s retirement plan. Additionally, owners of S corporations that anticipate a loss for the tax year need to calculate their available “basis” for claiming the loss.

Please contact us if you’d like to discuss your tax situation.

PRIME POINTS FOR YOUR BUY-SELL

Businesses with more than one substantial co-owner should have a buy-sell agreement. This agreement can help all parties when the inevitable happens, and one of the owners no longer can or will participate in the company as they had been. For the best result, your buy-sell should include a plan for what will happen when the following so-called “trigger events” occur.

Owner’s death

Assume a company is owned equally by Lynn Jones and Greg Harris. They both work full time, contributing to the company’s growth, until Greg dies unexpectedly.

A buy-sell can set the stage for Lynn to buy the company shares that Greg’s wife will inherit. A predetermined formula can set the buyout price, which Lynn will pay, and some life insurance can provide the funds she’ll need. Alternatively, the company might receive the insurance proceeds and buy in Greg’s shares, leaving Lynn as the sole owner.

Dealing with disability

In another scenario, Lynn suffers a serious illness and cannot work. The buy-sell can spell out how disability will be determined, whether Lynn will receive a salary, how long such a salary will continue, and how an ultimate buyout will be structured. Disability insurance may help to provide the necessary funds.

Defending against divorce

Considering the U.S. divorce rate and the demands of running a small business, it’s not surprising when a company co-owner has marital problems. However, if Greg is in a divorce negotiation, his wife may want a share of the company as part of the settlement—and Lynn might not welcome this additional partner.

Such a situation can be avoided if share transfers are restricted in some manner by the buy-sell agreement; the divorcing co-owner, the non-divorcing owners, or the company might be given the right of first refusal, so the divorcing spouse receives cash instead of shares. (Careful drafting is needed to avoid tax traps.) The buy-sell agreement should cover valuation, and the owners should have a plan to generate enough cash.

Ready for retirement

In yet another scenario, Lynn decides that she wants to retire while she is still young and healthy enough to enjoy her favorite pastimes. Greg intends to stay active in the business.

A buy-sell can set up a plan in which Lynn steps down and is compensated for her interest in the company, perhaps over an extended time period. Some life insurance policies can be structured to fund such a contingency.

Changing directions

What if Lynn wants to leave the company at, say, age 55 in order to try another career? A buy-sell agreement may distinguish between retirement and “withdrawal” or “departure,” perhaps based on age. A buy-sell could discount the purchase price if an owner leaves after relatively few years and could delay the payout until a certain time, if that’s what the co-owners agree upon.

Personal bankruptcy

Suppose that Greg incurs a tremendous amount of debt, either from extravagant living or from poor financial decisions not directly related to the company. He might file for personal bankruptcy to get relief. Again, the buy-sell can set a procedure for Lynn or the company to buy Greg’s shares so that his creditors get cash instead of interests in the business.

Time and money

Business owners commonly work long hours and need ample cash flow for company growth. Thus, owners of a small firm might not look forward to crafting a detailed buy-sell agreement, paying attorney fees, and committing to premium outlays for life insurance as well as disability insurance. That reluctance should be weighed against the outcome if one or more of the previously mentioned trigger events should arise without a buy-sell in place. A deceased partner’s heirs may inherit shares without a procedure in place for an equitable buyout; an owner’s divorce negotiations might spill over and affect company operations.

Our office can help you develop a buy-sell agreement that will protect you, your co-owners and your company from getting hurt when the trigger is pulled on these types of events.

Q&As REGARDING *my*RA PROGRAM

The Treasury Department recently released Q&As concerning its upcoming *my*RA program, which was first introduced by President Obama in his State of the Union address in January.

Purpose

The *my*RA program is intended to facilitate retirement saving by workers who lack access to an employer-sponsored retirement plan — either because the employer does not sponsor one or because the employee is ineligible for the employer's existing plan. The program is designed to encourage participation by individuals at lower to moderate income levels.

Operation

Accounts will have no fees and may be opened with an initial deposit of $25. Thereafter, employees may elect to contribute as little as $5 through automatic payroll deduction.

All deposits will be added to the value of a single security, which will be backed by the U.S. Treasury. This security will earn interest at the same variable rate as the Government Securities Investment Fund in the Thrift Savings Plan set up for federal employees.

Any employee who wishes to place his or her money in investments besides the government-backed security may — at any time — roll over the account balance to a private-sector retirement account.

Participants must roll over a *my*RA balance to another retirement account once it reaches $15,000 or after the account has been open for 30 years — whichever comes first.

Taxation

For tax purposes, *my*RAs will function as Roth IRAs. Therefore, contributions will be made after tax, but distributions — including earnings on the employee's contributions — will be tax free, provided the account has been open for five years and the employee is at least age 59½. Additionally, the employee's contributions may be withdrawn tax free at any time.

*My*RAs will also be subject to the same income eligibility limits as Roth IRAs. For 2014, eligibility to contribute to a Roth IRA phases out at the following levels of modified adjusted gross income (subject to inflation): $181,000 to $191,000 (married filing jointly), $114,000 to $129,000 (single and head of household), and $0 to $10,000 (married filing separately).

Employer responsibility

Employers will not be required to make *my*RAs available to their employees. Those employers who choose to participate will need — at the start of the program — to make *my*RA information available to their employees. However, employers will neither administer the accounts nor make employer contributions to them. Likewise, employees will be responsible for complying with the income limitations for making contributions.

LONGEVITY ANNUITIES IN IRAS AND EMPLOYER PLANS

Recently issued tax regulations clear the way for longevity annuities to be purchased through 401(k) and similar employer-sponsored retirement plans as well as individual retirement annuities and accounts (IRAs).

What are they?

Longevity annuities are deferred income annuities that provide a guaranteed income stream beginning at an advanced age and continuing for life. Individuals who are worried about the risk of outliving their retirement savings may be interested in purchasing a longevity annuity with a portion of their savings.

Key aspects of the new rules

The regulations allow eligible employer plans (and IRAs) to permit participants to use up to 25% of their account balances or (if less) $125,000 to purchase a "qualified longevity annuity contract" (QLAC).

For example, participants with a 401(k) account balance of $1,000,000 could use up to $125,000 to purchase a QLAC. The $125,000 dollar limit will be adjusted for inflation periodically.

Distributions from a QLAC must begin no later than age 85. Before annuitization, the value of the QLAC is excluded from the account balance used to determine required minimum distributions (or "RMDs," the minimum amounts that plan participants and traditional IRA owners generally must take from their accounts each year after reaching age 70½).

The new rules permit a QLAC to have a "return of premium" death benefit. With this feature, premiums paid for the annuity but not yet received as annuity payments would be paid to a beneficiary in the event of death.

The QLAC option may be offered by 401(k) and other qualified defined contribution plans, 403(b) plans, eligible governmental 457(b) plans, and traditional IRAs.

The lifetime income challenge

As more workers retire without traditional pensions and life expectancies increase, the challenge of managing retirement savings to last a lifetime assumes greater importance. Longevity annuities are an option that retirees may wish to consider.

SHANNON & ASSOCIATES GIVES BACK

This year, we at Shannon & Associates have taken several opportunities to give back in our community. Listed below are some of the great causes we have been honored to be a part of.

Wings of Karen 5k Bra Dash

The 3rd Annual Wings of Karen 5k Bra Dash was a powerful and inspirational event. The vision to fund our local research community and encourage all those facing breast cancer was realized as a fantastic turnout of participants and volunteers came together to dash in pursuit of a cure. Almost $150,000 was raised to help advance promising breast cancer research. It truly was a celebration of what we all can do as a community to create a world without breast cancer.

We were honored to have Dr. Mary Claire King speak to us this year, with her emphatic words.

"There is no other foundation like Wings of Karen, which allows researchers like me the flexibility to do what needs to be done to find a cure for breast cancer with no strings attached."

United Way Day of Caring

A whopping 11,800 volunteers lent their time and energy to nonprofits all over the community as part of the 2014 United Way Day of Caring. This is truly the prime time in King County for people to come together to give back.

We at Shannon & Associates went out and did some painting in the Hillside Lodge building at Camp Berachah in Auburn. We had 12 volunteers and were able to paint 6 rooms before the day was done.

Kent Turkey Challenge

We partnered with several Kent businesses taking part in the 4th Annual Kent Turkey Challenge!

The 4th Annual Kent Turkey Challenge is a competition between Kent businesses and organizations to collect the most food and money for the Kent Food Bank to help feed families a Thanksgiving meal. This year we have a goal of raising $17,000 and 4,000 lbs of food.

Over the past three years the Annual Kent Turkey Challenge has raised over $34,500 and 6,400 lbs of food for the Kent Food Bank!

This year our office raised $440 and brought in 49 nonperishable food items.

SHAREHOLDERS OF S-CORPORATIONS

Shareholders of S-corporations, as we move into December there are two things that you need to do.

Self-employed health insurance deduction

Shareholders who own more than 2% of the shares in the S-corporation are required to report health insurance premiums paid on their behalf by the business on their W-2. This is a valuable deduction and must be reported correctly to take advantage of it. Attribution rules apply so premiums paid on behalf of family members who are not shareholders must be reported on their W-2 as well. We cannot take the health insurance deduction on the corporate return without it coming through the shareholders' W-2.

The insurance policy that provides your insurance can either be in the name of the S-corporation or in the name of the shareholder. The premiums can be paid by the shareholder or the corporation. However, where the policy is in the shareholder's name (you individually), the corporation must reimburse you before year-end (12/31) if you personally paid the premiums.

Premium amounts are a "deemed wage" and are reported in Box 1 of your Form W-2. This "deemed wage" from payment of health insurance premiums is not subject to FICA or FUTA taxes.

In summary, the corporation deducts the health insurance premium paid on your behalf as an expense, you report this as income on your W-2, and you deduct the same amount on page 1 of your Form 1040 as a self-employed health insurance premium. The IRS can deny your Form 1040, Page 1 self-employed health insurance deduction if you do not report the premiums as part of Box 1 wages on Form W-2.

Personal use of company owned autos

The value of using a company auto for personal purposes is a fringe benefit that is taxable to the employee and to the shareholder. This benefit is treated as compensation and is subject to payroll taxes including FICA and FUTA tax.

There are several different methods to compute the value of personal use of company autos. If you would like any assistance with this calculation, please contact our office. Once the amount is determined, it is added to the gross wages of the individual receiving the benefit.

Reporting

If you use a payroll service to prepare your payroll and W-2's, you will need to notify them of the shareholder insurance amount and auto fringe benefit amount before the final payroll processing in December. Often, the final payroll processing date is mid-December so now is a good time to gather this information.

Fringe benefits like the shareholder health insurance and personal use of company autos are considered wages and are included in the Form 941 and 940 wages as well as added to W-2's.

These issues can be complex. Please contact us for assistance in calculations or if you have any questions.

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