Tax & Business Alert

DECEMBER 2014

SUPERSIZING YOUR CHARITABLE CONTRIBUTION DEDUCTIONS

You might want to consider three charitable giving strategies that can help boost your 2014 charitable contributions deduction.

1. Use Your Credit Card. Donations charged to a credit card are deductible in the year charged, not when payment is made on the card. Thus, charging donations to your credit card before year-end enables you to increase your 2014 charitable donations deduction even if you're temporarily short on cash or just want to put off payment until later.

2. Donate a Life Insurance Policy. A number of charities are asking their donors to consider donating life insurance policies rather than (or in addition to) cash in order to make substantially larger gifts than would otherwise be possible. The advantage to donors is that they can make a sizable gift with relatively little up-front cash (or even no cash, if an existing policy is donated). The fact that a charity may have to wait many years before receiving a payoff from the gift is typically not a problem because charities normally earmark such gifts for their endowment or long-term building funds.

If handled correctly, a life insurance policy donation can net the donor a charitable deduction for the value of the policy. A charitable deduction is also available for any cash contributed in future years to continue paying the premiums on a policy that was not fully paid up at the time it was donated. However, if handled incorrectly, no deduction is allowed. For this reason, we encourage you to contact us if you are considering the donation of a life insurance policy. We can help ensure that you receive the expected income or transfer tax deduction and that the contribution works as planned.

3. Take Advantage of a Donor-advised Fund. Another charitable giving approach you might want to consider is the donor-advised fund. These funds essentially allow you to obtain an immediate tax deduction for setting aside funds that will be used for future charitable donations.

With donor-advised funds, which are available through a number of major mutual fund companies, as well as universities and community foundations, you contribute money or securities to an account established in your name. You then choose among investment options and, on your own timetable, recommend grants to charities of your choice.

The minimum for establishing a donor-advised fund is often $10,000 or more, but these funds can make sense if you want to obtain a tax deduction now but take your time in determining or making payments to the recipient charity or charities. These funds can also be a way to establish a family philanthropic legacy without incurring the administrative costs and headaches of establishing a private foundation. ■

UNICAP RULES AND EXEMPTIONS

A set of tax rules known as the uniform capitalization (UNICAP) rules require certain business costs that are normally expensed as they're incurred to instead be capitalized as part of the cost of inventory held for resale or noninventory items produced by a taxpayer for use in its trade or business.

The rules are far from new, having been around since the mid-1980s. However, a recent Tax Court decision is a reminder that the rules can be a trap for the unwary. The taxpayer in the case was a homebuilder who capitalized the direct material and labor costs of constructing the homes, as well as post-completion carrying costs until the houses were sold. However, it failed to capitalize a whole host of generally indirect costs that the IRS and the Court found to be related to completing the homes (from front office salaries and overhead, to the cost of supervisors, designers, and decorators). The end result was the taxpayer faced a substantial additional tax bill.

Fortunately, there are several exceptions to the UNICAP rules that exempt numerous businesses from having to comply with them (including most service businesses, small to medium-sized retailers, and even most homebuilders with sales of no more than $10 million, along with many in the farming and oil and gas businesses). However, many other businesses are subject to the rules, sometimes without even knowing it—for example, where the business previously qualified for an exemption but has outgrown it or otherwise no longer meets the requirements.

Give us a call if you have questions about whether your business is subject to the rules or qualifies for an exemption. ■

RETAINING KEY EMPLOYEES

Unless you have capable successors and employees, your closely held business may not survive. Therefore, strategies to identify, retain, and reward key employees are a must. There are numerous methods for rewarding a key employee's commitment, loyalty, and hard work. The most effective incentives are usually monetary. Generally, they are offered in the form of nonqualified plans so the incentive can be tailored to a particular person's situation.

Nonqualified plans are much more flexible than qualified plans concerning benefits, contributions, and participation requirements. Nonqualified plans also provide the opportunity to "tie" the employees to the business by incorporating conditions that cause the forfeiture of benefits if the employee leaves or the business does not reach certain performance targets. Let's look at some options.

- **Restricted Stock.** A restricted stock plan transfers stock to an employee subject to certain restrictions. Often, the shares are transferred to the employee at little or no cost, but are subject to forfeiture if the employee fails to fulfill the terms of the plan. A common restriction requires employees to forfeit their shares if they terminate employment within a certain number of years.
- **Incentive Stock Options (ISOs).** ISOs can provide key employees additional compensation through the opportunity to share in the appreciation of the company's stock value. ISOs are usually granted to the employee at no cost with an exercise price at or above the stock's current market price.
- **A Nonqualified Stock Option (NQSO).** An NQSO is an option that specifically states it is an NQSO or one that does not meet the requirements of an ISO. Like an ISO, you can use an NQSO to provide key employees additional compensation through the opportunity to share in the appreciation of the company's stock value. ■

HOME OFFICE EXPENSES OF EMPLOYEES

In our always-connected, always-on business environment, it isn't unusual for employees to work from home on a regular basis. For the majority of individuals, this work occurs in the evenings, or on weekends or holidays, when they're not otherwise expected to be in the office. However, for an increasing number of employees, they're telecommuting all or almost all of the time. When they do show up in the office, it is frequently just for group meetings or other gatherings, not to put in a "regular" day's work sitting in an office, cubicle, or other workspace.

It is employees in this latter situation who may be interested in a recent Tax Court decision involving a telecommuting employee with large home office deductions. However, before we get to this case, let's quickly review the general requirements for a deduction.

The rules allowing a home office deduction if you're *self-employed* generally require that the space be used regularly and exclusively—

- as a principal place of business,
- as a place to meet or deal with clients and customers in the normal course of business, or
- "in connection with" the business if the space is a separate structure from the residence (e.g., a barn or detached garage).

When you're an employee (rather than self-employed), you have to meet one of the above requirements and the *employer convenience test*. This test is hard to satisfy, unless your employer doesn't provide you with an appropriate space in which to get your work done. This was the situation in a recent court case.

The case involved an employee hired to work in New York for an employer in the marketing and public relations field whose only offices were in California. The plan was to secure office space in New York, but that never happened and the employee worked out of her apartment, utilizing about a third of its space as a home office. The employer listed the employee's apartment as its New York office and the phone number listed for that office was the employee's landline phone. The employee worked out of the home office throughout the year and even saw clients there on a regular basis. Due to the company's tight financial condition, she was never reimbursed for any of her home office expenses. As a result, she claimed a large home office deduction.

Although the IRS disallowed the entire deduction, the court found that the taxpayer met the "employer convenience test" and sustained a deduction for a third of her rent and cleaning expenses—equal to the third of her studio apartment used as a home office. It did this despite the fact that she technically didn't meet the "exclusive use" part of the test for claiming the deductions because she occasionally did non-business activities in the home office and had to regularly walk through the space to get to and from the sleeping quarters.

If you are regularly working from home because your employer doesn't provide you with appropriate space from which to perform your job and you are not currently claiming a home office deduction, we should talk. It could be that you're entitled to some additional deductions. ■

CHECK YOUR PARTNERSHIP AND S CORPORATION STOCK BASIS BEFORE YEAR-END

If you own an interest in a partnership or S corporation, your ability to deduct any losses it passes through is limited to your basis. Although any unused loss can be carried forward indefinitely, the time value of money diminishes the usefulness of these suspended deductions. Thus, if you expect the partnership or S corporation to generate a loss this year and you lack sufficient basis to claim a full deduction, you may want to make a capital contribution (or in the case of an S corporation, loan it additional funds) before year end. ■

DISABILITY INSURANCE FOR BUSINESS OWNERS AND PROFESSIONALS

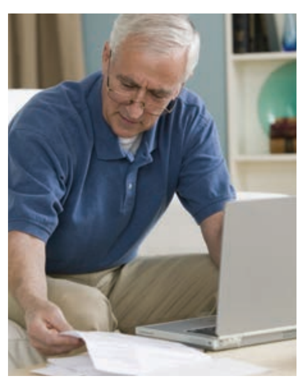
As you probably know, it is wise to have disability insurance coverage to protect you and your family from loss of earnings in the event you become unable to work. Studies show that the possibility of permanent disability is far greater than death during a person's working lifetime. It can also have a much greater financial impact on the family. Disability might not only remove a source of family income, it may also increase family expenditures as the disabled person must be fed, clothed, and sheltered, and the family may be faced with large, ongoing medical expenditures.

Disability insurance needs are usually based on the level of wages that would be lost if you were disabled. However, a more precise method may be needed if you have other income sources or special funding needs, such as unfunded education costs.

The benefits paid under a disability insurance policy can be totally tax-free to you, 100% taxable, or partially taxable depending on the type of policy, who pays the premiums, and whether or not they are paid with pre-tax dollars. ■

SENIORS AGE 70½+: TAKE YOUR REQUIRED RETIREMENT DISTRIBUTIONS

The tax laws generally require individuals with retirement accounts to take annual withdrawals based on the size of their account and their age beginning with the year they reach age 70½. Failure to take a required withdrawal can result in a penalty of 50% of the amount not withdrawn.



If you turned age 70½ in 2014, you can delay your 2014 required distribution to 2015. Think twice before doing so, though, as this will result in two distributions in 2015—the amount required for 2014 plus the amount required for 2015, which might throw you into a higher tax bracket or trigger the 3.8% net investment income tax. On the other hand, it could be beneficial to take both distributions in 2015 if you expect to be in a substantially lower tax bracket in 2015. ■