Harris, Burnett & Schmiesing CPAs

7730 Olentangy River Road
Columbus, OH 43235
(614) 436-CPAS

A tax, business, and financial planning newsletter for our clients and friends

CLIENT'S tax & financial UPDATE

VOLUME **38** / NUMBER **6**

JULY – AUGUST 2016 ISSUE

Tax Opportunities for a Comfortable Retirement

There are several ways to take advantage of loopholes in the tax laws to enhance your retirement. Here are the most effective strategies to consider.

Sell your home tax-free.

The tax law does much more for home owners than simply letting them take a $250,000/$500,000 tax-free gain on sale. Here are additional ways the law helps some owners save taxes...

- A home qualifies as a principal residence, on which you can take tax-free gain, if you've lived in and owned it for only two out of the previous five years. So, if you moved out of your home up to three years previously, and perhaps have rented it out for profit in the meantime, it will still qualify as a residence on which you can take tax-free gain.
- You can take tax-free gain multiple times. The law allows you to use the $250,000/$500,000 exclusion once every two years.
- Transfers of homes to children made easier. Some parents who approach retirement age desire to make a gift of the family residence to their grown children. The drawback to this was that when a home had appreciated in value, for income tax purposes it was better for children to receive it by inheritance than by gift. Current tax law eliminates this problem for many by enabling a child who receives a home by gift to use the $250,000/$500,000 exclusion to eliminate the gains tax that otherwise would be due, provided the child uses the home as his/her principal residence for at least two years.

CONTINUED ON PAGE **4**

taxPOINTS

Divorced or separated parents are often in different tax brackets. At filing time they should determine who will have the greater tax benefit from claiming the children. **Planning tool:** If the parent who usually claims the exemption is in a lower tax bracket, the exemption can be taken by the higher bracket parent simply by filing IRS Form 8332.

Part-time businesses should have their own bank accounts and bookkeeping records. The better your records the less chance you have that the IRS will disallow your business deductions.

Premiums paid on the purchase of taxable bonds may be written off over the term of the bond. It's deducted as investment interest expense. **For example,** you purchase a 6% 5-year $5,000 face value bond for $6,000. The additional $1,000 you paid for the bond is deductible proportionately over the life of the bond.

Deduct personal property donated to charity. This deduction is often not taken because people neglect to obtain a receipt for their contribution. The deduction is limited to the lesser of the fair market value or original cost of the donated property (i.e. furniture and clothing).

Pay Estate Taxes With Low-Cost Insurance

The unlimited marital deduction generally exempts the estate of a married couple who leave their assets to each other from federal taxes when the first spouse dies. However, when the surviving spouse dies, the spouse's assets will be subject to federal taxes at a rate which can be as high as 40%. A problem can arise if there is not enough cash in the estate to pay the taxes.

Payment of a surviving spouse's estate taxes can be provided for by buying a type of life insurance known as survivorship or second-to-die insurance. In the case of a married couple, benefits from survivorship life insurance are not paid until the surviving spouse dies. The cost of this type of life insurance is considerably less than the cost of conventional life insurance because the insurance company's risk is based on two lives.

In addition to providing payment of the survivor's estate taxes, survivorship life insurance offers other advantages. Arrangements can be made to transfer the policy's ownership to the survivor's children. This removes the policy proceeds from the surviving spouse's estate and protects them from estate taxes.

Furthermore, it's often possible to buy survivorship insurance when one spouse can't get single life coverage because of poor health.

Best Pricing Strategies

Smarter discount policies

- Whenever possible, avoid putting discount policies in print. If industry practice or business regulations require the publishing of discounts, keep your published discounts small so you can negotiate better prices for important customers.
- Change your discounts often. If discounts stay the same, they are often perceived as actual prices. This can make future price increases very difficult.

Be a price follower...

- When your company is small and a few large competitors dominate your industry.
- When there's little or no difference between your product or service and that of your competition.
- When you are ready and willing to continue to be a price follower.

When You Can Deduct Personal Legal Fees

When incurred by a business, legal fees are generally deductible as an ordinary business expense. However, legal fees for personal matters are deductible as miscellaneous itemized deductions only if they are incurred for the following services:

- The collection or production of income.
- The management of income producing property.
- The resolution of tax matters such as tax determination, collection or refund.

In addition, there are certain personal matters for which legal fees may be deductible. Some of these include the following.

Executor's commission. An executor who incurs legal fees to obtain taxable income can claim a deduction.

Probate. Legal fees paid for probate by an estate are deductible on the estate tax return, but strong substantiation of the legal time involved is necessary.

Social Security. Legal fees incurred to collect Social Security benefits are deductible to the extent that the Social Security benefits are taxable. **For example,** if one-half of the benefits are taxable, then one-half of the legal fees are deductible.

Alimony. Legal fees incurred for the receipt of alimony are deductible. To support this deduction, your attorney must give you an itemized bill that shows how the legal fees were allocated to tax and to non-tax matters.

Personal injury suits. If damages are awarded for lost wages, the portion of the legal fees attributable to recovery of the wages is deductible.

Home Office Deductions

Having your own business can enable you to have a qualified home office – and deduct expenses for your home that otherwise would be non-deductible.

Examples: Depreciation, insurance, maintenance, repairs, and utilities allocable to the part of your home used as an office.

The office must be a part of your home that you use exclusively for business on a regular basis. It must be either your principal place of business or needed for essential business record keeping.

Strategy: Take photos or a video of your office space to show how it is used, to be available in case you are ever audited – even after you may have sold the home.

Deducting Your Spouse's Travel Costs

If there is a legitimate business reason why you take your spouse with you on a business trip, you can deduct his or her travel costs. In addition, some of your spouse's travel costs may be deductible even if there is no business reason for the spouse's travel. Some examples:

- **Hotels.** If the rate for a single room is $250 and the rate for a double room is $300, you can deduct $250 of the $300 double room rate.
- **Entertainment.** If you and your spouse entertain a customer, 50% of the cost is deductible.
- **Travel.** If the cost of your single regular fare is $600 and you are able to purchase special tickets for $400 each for a couple, you can deduct the regular $600 fare if you take your spouse.
- **Meals.** As is true of all business meals, 50% of the cost is deductible if your spouse and you have a meeting with a customer and business is discussed.

CONTINUED FROM PAGE 1

Tax Opportunities For a Comfortable Retirement (continued)

Sell your home to your children and rent it back from them.

Here's a way that both you and your children can get benefits from Uncle Sam. You benefit because you get retirement money from the sale of your home. You can also pay less rent because your children can charge you a "fair rent", which one Tax Court has ruled can be lower than "fair market rent" since renting to relatives entails less risk than renting to strangers.

Your children benefit because they can deduct mortgage interest, taxes, and depreciation... deductions that mean greater tax savings to your high-tax-bracket children than they mean to you as a lower-tax-bracket retiree.

Control your retirement plan distribution.

The law requires that you begin to withdraw money from your IRA by April 1 following the year in which you become 70½. By using actuarial tables, you may be able to take out less money during the early years to avoid increasing your income to a higher tax bracket. Your IRA trustee can tell you whether you can slow down your retirement plan distribution withdrawals.

Municipal bond interest.

This is generally tax exempt from federal income tax – and may be exempt from state and local income tax as well. ***Caution:*** Certain municipal bonds, known as "private activity bonds" (because they finance nongovernmental functions, such as construction of sports stadiums), pay interest that is taxable under the alternative minimum tax (AMT).

Use life insurance to pay your estate taxes.

Look into establishing a trust to purchase life insurance, the proceeds from which would pay your estate taxes. If you're in your early sixties or younger, life insurance premiums may be a low-cost way to pay estate taxes.

Protect your assets against nursing home costs.

The government won't pay your nursing home costs until all money in your name has been exhausted. But if your money is in a trust that pays income and doesn't give you access to the principal, only the income will go to the nursing home and the principal will remain intact. Be sure to consult an attorney about the laws in your state, because many states will not honor such a trust if it is set up within five years of the time you enter a nursing home.

A wise way to use a power of attorney.

Protect yourself against the possibility that you might become incapacitated and be unable to manage your money. By giving power of attorney over a special bank account to someone you trust, you can be sure that money will be available to take care of you.

How To Delegate Successfully

Delegating responsibility is one of the keys to good management. Here are some principles to follow for effective delegation.

- Delegate early, never at the last minute.
- Make certain that the person to whom you delegate a task wants to do the task.
- Make it clear whether the delegation is permanent or temporary.
- Always delegate total tasks, not portions of them.
- When you delegate a task, delegate the authority and responsibility that go along with it.
- Once you delegate, don't interfere, but make it clear that you are available for advice and assistance.
- When you delegate a complex task, demonstrate it clearly, and have staff members repeat what you did until it's clear they understand the task.
- Review and evaluate the results and discuss them with the staff member.
- Acknowledge good performance and make sure that all criticism is constructive.