# Harris, Burnett & Schmiesing CPAs

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



CLIENT'S tax & financial UPDATE

VOLUME **36** / NUMBER **1**

SEPTEMBER - OCTOBER 2013 ISSUE


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



# Vacation Home and Travel Tax Breaks

A vacation home can provide you and your family with lots of good times. If you own a vacation home it could also provide you with many tax benefits to make your ownership less costly and more enjoyable. Here are some surprising tax advantages to home ownership you should not overlook.

## HOME AND VACATION HOME

Many people do not fully use their vacation home as much as they could and as time passes they might even use it less. Even with less personal use you still have to pay your mortgage, real estate taxes, insurance and maintenance costs.

- **Obtain tax-free income from your home or vacation home.** If you own and rent out your home or second home for 14 days or less a year, the rental income paid to you is not taxable. You are not even required to report it to the IRS on your tax return. **Planning note:** If your home or vacation home is located in a vacation area or where special events draw high numbers of visitors at certain times of the year, you can rent it out tax-free for up to fourteen days and use the money toward your ownership costs or to pay some of your own travel costs.
- **Deduct your mortgage interest on your home or vacation home.** The mortgage interest deduction is a great tax benefit that can make your ownership less costly. In general, you can deduct up to $1 million ($500,000 if you are married filing separately) on the

interest of mortgage borrowing used to acquire your primary residence. This same limit applies whether you have one home or two. **Loophole:** Your second home may be a boat or a recreational vehicle.

CONTINUED ON PAGE **4**

## taxPOINTS

**The annual gift tax exclusion is $14,000 per donor. Added benefit:** A husband and wife can agree to treat the gift as being made equally by each and increase the exclusion to $28,000.

**Loophole: Donations to charity** of appreciated long-term capital gain assets can be deducted on your tax return at the fair market value of the asset, which is often higher than your cost basis. **Added benefit:** You do not have to report as income on your tax return the appreciation in value of the asset.

**Entertainment expenses** are not deductible unless the entertainment has come before or followed a "substantial business discussion". Have a business meal with an associate before or after the entertainment event. Be sure to keep a record of the date, time, place and the business topic which was discussed. This supports a 50% deduction of the cost of the meal and the entertainment event.

**When can I dispose of my personal tax records?** Tax records must be kept for three years. However, if you understate your income by more than 25%, tax returns/records must be kept for six years. If your return is fraudulent or you did not file, there is no limitation. It is also very important to retain all records relating to the following: investments, home, stocks and bonds, collectibles, and retirement savings, for as long as you own them in addition to the limitation period.

# How to Make Sure a Loan from Your Company Isn't Taxed as a Dividend

It's not unusual for business owners to borrow money from their company. However, it's possible that the IRS might consider such a transaction as a corporate distribution and tax it as a dividend.

If you borrow money from your company, the most important thing you can do to avoid the dividend tax problem is to document the transaction in the same manner as a loan agreement. Include all the details in writing, including the rate of interest, the term of the loan, repayment schedules, security, and all other relevant information.

When the IRS considers the legitimacy of a loan it questions several aspects of the transaction:

- How large is the transaction?
- Is the loan secured?
- Does the corporation take steps to assure timely payment?
- Is there proof that the borrower is repaying or intends to repay the loan?
- To what extent does the borrower control the corporation?

In addition, if no dividends have been previously paid by the corporation, the IRS may look more closely at the transaction.

# Preparing for a Sales Call: A Five-Point Checklist

1. **Stress benefits.** Remember that your prospect is thinking, "What's in it for me?"
2. **Be ready for objections.** Have your answers prepared before you make the call.
3. **Be enthusiastic.** People buy when they're enthusiastic about your product. Being upbeat is the best way to create enthusiasm.
4. **Don't talk too much.** Remember that most sales take place when the prospect is talking.
5. **Don't oversell your product.** It's much better to identify a prospect's problems and show how you can help solve them.

# Taking the Mystery Out of Business Planning

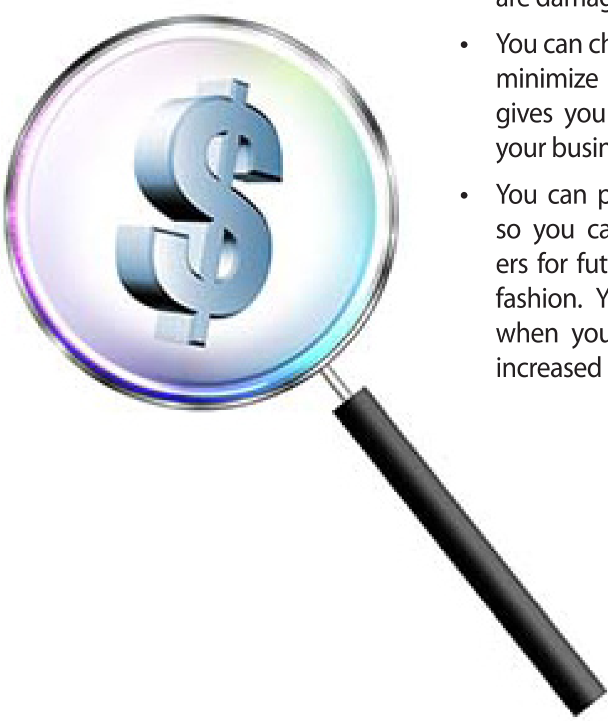
**PROPER PLANNING IS ESSENTIAL TO THE SUCCESS OF ANY BUSINESS, LARGE OR SMALL.**

Formal business plans are a way of life for larger firms, but many smaller companies operate without one, frequently because management is not aware of the many advantages of good planning.

A business plan is nothing more than the setting of goals and the development of strategies that will help a business reach those goals. It's a disciplined, orderly system of predicting where a business is going and how it will get there. Once it's in place, all that remains is to measure a company's performance against its plan and change strategies when indicated.

## DEVELOPING A PLAN

The basic ingredient of a business plan is forecasting company performance in four major areas: sales, costs, selling prices, and profits. Since these areas directly affect each other, they help management make critical business decisions. For example, if costs are higher than forecasted, a price increase may be called for. But higher selling prices can reduce sales, which can have a negative effect on profits.



## THE BENEFITS OF PLANNING

When the four basic elements of a business plan have been forecasted and strategies to reach the plan goals are in place, company performance can be monitored on a regular basis. It's the ability to measure performance that provides the many benefits of planning. Here are just a few:

- You can identify problems quickly, often before they develop. You run your business instead of letting it run you. If, for example, costs are higher than you projected, you can increase prices before profits are damaged.
- You can choose strategies that will minimize taxes because a plan gives you an ongoing picture of your business operations.
- You can project personnel needs so you can hire and train workers for future needs in an orderly fashion. You'll know in advance when your workforce should be increased or cut back.
- Your employees will be dedicated to reach the plan goals because they play an active role in setting those goals.
- You'll be able to control inventory much more efficiently, which will improve cash flow and smooth out production problems.
- You'll obtain financing faster and easier because a business plan is essential if you want to borrow for any extended period. In fact, lenders will insist that you submit a business plan so they can base their decision on information rather than speculation.
- The plan you use the first year will be invaluable for developing your plan for the following year. When you compare your company's actual performance with the plan's projections, subsequent plans become easier, more accurate, and more useful.

Some businesses can re-examine their plan annually or semi-annually, but a monthly review is usually more productive. Most of the information you need for plan reviews is available in your accounting records. Your accountant can help you set up a system that will give you the information you need for periodic reviews.

CONTINUED FROM PAGE 1

## *Vacation Home and Travel Tax Breaks (continued)*

The second home must have living accommodations and, if rented, must be used by the taxpayer for more than 14 days or 10 percent of the number of days that it is rented out at fair market value, whichever is greater. All real estate and property taxes paid on your second home are also deductible.

- **Vacation home tax deductions.** If you purchase your vacation home for rental and your personal use does not exceed 14 days during the year your vacation home qualifies as rental property. As rental property all the income you receive is taxable, but you can deduct all your expenses including taxes, mortgage interest, insurance, utilities, repairs, maintenance and depreciation. You can even deduct dinnerware, towels and bedsheets.

If at the end of the year your expenses exceed your income you can deduct up to $25,000 of your losses, on your tax return, if you actively participate in your rental activities. This can mean performing some duties, such as, approving new tenants or paying the bills. The loss deduction phases out when your adjusted gross income is between $100,000 and $150,000.

The rental loss deduction can turn your vacation home into a tax shelter. As your home appreciates in value, you are allowed to claim your losses even if you have positive cash flow. The depreciation deduction provides an added paper deduction with no cash cost.

- **Tax-free gain on sale.** If your vacation home increases in value and you are thinking of selling, you should consider converting your vacation home into your primary residence and take advantage of the $250,000 ($500,000 on a joint return) exclusion of gain on the sale of a primary residence. **Strategy.** You must move into your vacation home and use it as your primary residence for at least two years out of the previous five years before selling. **Added bonus:** Sell your primary residence and then move into your vacation home and sell it, this could give you two tax free sales. You must meet the ownership test (owned the home for at least two years, and during this period did not exclude gain from the sale of another home).

# Tax Tips

### Don't gift your home to your child

If you gift your home to your child while you're still living, the IRS will consider the child to have received it on a "carryover basis", which is your original cost plus certain adjustments. When the house is later sold, the child will be taxed on the difference between the adjusted carryover basis and the sales price.

On the other hand, if you *will* your home to your child, the tax consequences will be more favorable. You and your spouse can will up to $10,500,000 in assets free of estate taxes, and if your child sells the inherited house, the taxable gain will be based on the difference between a stepped-up basis and the sale price – usually a substantial savings.

### Job hunting expenses

When seeking a new job in your current line of work your job hunting expenses are deductible as an itemized deduction. The expenses are deductible even if you are out of work or the search is not successful. Included in job hunting expenses are resume costs, transportation, meal and entertainment expenses, travel expenses, and employment agency fees.