Stone and Spring
Certified Public Accountants

112 Elden Street, Suite I ▲ Herndon, VA 20170 ▲ 703.904.9027 ▲ Fax 703.904.9029 ▲ www.stoneandspring.com

Tax & Business Alert

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THE IMPORTANCE OF UPDATING BENEFICIARY DESIGNATIONS

Most of us have more than enough to do. We're on the go from early in the morning until well into the evening—six or seven days a week. Thus, it's no surprise that we may let some important things slide. We know we need to get to them, but it seems like they can just as easily wait until tomorrow, the next day, or whenever.

A U.S. Supreme Court decision reminds us that sometimes *whenever* never gets here and the results can be tragic. The case involved a $400,000 employer-sponsored retirement account, owned by William, who had named his wife, Liv, as his beneficiary in 1974 shortly after they married. The couple divorced 20 years later. As part of the divorce decree, Liv waived her rights to benefits under William's employer-sponsored retirement plans. However, William never got around to changing his beneficiary designation form with his employer.

It's important to keep your beneficiary designations up to date.

When William died, Liv was still listed as his beneficiary. So, the plan paid the $400,000 to Liv. William's estate sued the plan, saying that because of Liv's waiver in the divorce decree, the funds should have been paid to the estate. The Court disagreed, ruling that the plan documents (which called for the beneficiary to be designated and changed in a specific way) trumped the divorce decree. William's designation of Liv as his beneficiary was done in the way the plan required; Liv's waiver was not. Thus, the plan rightfully paid $400,000 to Liv.

The tragic outcome of this case was largely controlled by its unique facts. If the facts had been slightly different (such as the plan allowing a beneficiary to be designated on a document other than the plan's beneficiary form), the outcome could have been quite different and much less tragic. However, it still would have taken a lot of effort and expense to get there. This leads us to a couple of important points.

1. If you want to change the beneficiary for a life insurance policy, retirement plan, IRA, or other benefit, use the plan's official beneficiary form rather than depending on an indirect method, such as a will or divorce decree.
2. It's important to keep your beneficiary designations up to date. Whether it is because of divorce or some other life-changing event, beneficiary designations made years ago can easily become outdated.

One final thought regarding beneficiary designations: while you're verifying that all of your beneficiary designations are current, make sure you've also designated secondary beneficiaries where appropriate. This is especially important with assets such as IRAs, where naming both a primary and secondary beneficiary can potentially allow payouts from the account to be stretched out over a longer period and maximize the time available for the tax deferral benefits to accrue. ■

SELECTING THE APPROPRIATE ENTITY FOR YOUR BUSINESS

A principal consideration for any business, whether new or existing, is choosing an appropriate legal entity. Available options in most states include C corporations, S corporations, general and limited partnerships, limited liability companies (LLCs), limited liability partnerships (LLPs), and sole proprietorships.

Each type of entity has various advantages and disadvantages. One issue to consider is tax savings. The proper entity can minimize self-employment and income taxes. Understanding the total tax situation, including income tax, payroll tax, and estate tax exposure is essential in determining the choice of entity.

Personal liability protection is often an owner's main objective in choosing the appropriate entity. Operating as a proprietorship or general partnership offers no owner liability limitation. Limited partnerships, LLCs, LLPs, S corporations, and C corporations provide varying degrees of liability protection for the owners depending on state law. For sole owners, the single-member LLC is a popular liability-limiting alternative to a proprietorship.

If a business is owned by more than one individual, it cannot be run as a proprietorship. If all owners provide management services, a limited partnership is not a viable option because that would jeopardize their status as limited partners. Limited partnerships, LLPs, LLCs, C corporations, and S corporations allow for management by multiple individuals without limitations.

In many cases, a change in entity status is sought to accomplish a transition in ownership. Whether the objective involves moving ownership to a successor via gifts, an installment sale, a stock redemption, a bequest, or a combination of methods, it is often necessary to use a different form of entity to meet these objectives.

Each entity selection situation is unique. The business owner's objectives must be systematically matched with the various entities' attributes. All major tax and nontax issues must be considered and alternatives explored before choosing the appropriate structure for your business.

As with most business decisions, meaningful, up-front planning will have a positive and lasting effect on your business venture. Please call us with questions about the appropriate entity structure for an existing business, a business you intend to purchase, or a contemplated new start-up business. ■

TIPS FOR DEDUCTING LOSSES FROM A DISASTER

If you suffer damage to your home or personal property, you may be able to deduct the losses you incur on your federal income tax return. Here are some things you should know about deducting casualty losses:

- *Casualty loss*. You may be able to deduct losses based on the damage done to your property during a disaster. A *casualty* is a sudden, unexpected, or unusual event, such as a natural disaster (e.g., a hurricane, tornado, flood, or earthquake), fire, accident, theft, or vandalism.
- *Normal wear and tear*. A casualty loss does not include losses from normal wear and tear or progressive deterioration from age or termite damage.
- *Covered by insurance*. If you insured your property, you must file a timely claim for reimbursement of your loss. If you don't, you cannot deduct the loss as a casualty or theft.

As a general rule, you must deduct a casualty loss in the year it occurred.

- *When to deduct*. As a general rule, you must deduct a casualty loss in the year it occurred. However, if you have a loss from a federally declared disaster area, you may have a choice of deducting the loss on your return for the year the loss occurred or on an amended return for the immediately preceding tax year.

- *Amount of loss*. Your loss is generally the lesser of (1) your adjusted basis in the property before the casualty (typically, the amount you paid for it); or (2) the decrease in fair market value of the property as a result of the casualty, reduced by any insurance or other reimbursement you received or expect to receive.
- *$100 rule*. After you have figured your casualty loss on personal-use property, you must reduce that loss by $100. This reduction applies to each casualty loss event during the year. It does not matter how many pieces of property are involved in an event.
- *10% rule*. You must reduce the total of all your casualty or theft losses on personal-use property for the year by 10% of your adjusted gross income. ■

THE MANY BENEFITS OF A HEALTH SAVINGS ACCOUNT (HSA)

A Health Savings Account (HSA) represents an opportunity for eligible individuals to lower their out-of-pocket health care costs and federal tax bill. Since most of us would like to take advantage of every available tax break, now might be a good time to consider an HSA, if eligible.

An HSA operates somewhat like a flexible spending account (FSA) that employers offer to their eligible employees. An FSA permits eligible employees to defer a portion of their pay, on a pretax basis, which is used later to reimburse out-of-pocket medical expenses. However, unlike an FSA, whatever remains in the HSA at year-end can be carried over to the next year and beyond. In addition, there are no income phase-out rules, so HSAs are available to high-earners and low-earners alike.

Naturally, there are a few requirements for obtaining the benefits of an HSA. The most significant requirement is that an HSA is only available to an individual who carries health insurance coverage with a relatively high annual deductible. For 2015, the individual's health insurance coverage must come with at least a $1,300 deductible for single coverage or $2,600 for family coverage. For many self-employed individuals, small business owners, and employees of small and large companies alike, these thresholds won't be a problem. In addition, it's okay if the insurance plan doesn't impose any deductible for preventive care (such as annual checkups). Other requirements for setting up an HSA are that an individual can't be eligible for Medicare benefits or claimed as a dependent on another person's tax return.

Individuals who meet these requirements can make tax-deductible HSA contributions in 2015 of up to $3,350 for single coverage or $6,650 for family coverage. The contribution for a particular tax year can be made as late as April 15 of the following year. The deduction is claimed in arriving at adjusted gross income (the number at the bottom of page one on your return). Thus, eligible individuals can benefit whether they itemize or not. Unfortunately, however, the deduction doesn't reduce a self-employed person's self-employment tax bill.

When an employer contributes to an employee's HSA, the contributions are exempt from federal income, social security, Medicare, and unemployment taxes.

An account beneficiary who is age 55 or older by the end of the tax year for which the HSA contribution is made may make a larger deductible (or excludible) contribution. Specifically, the annual tax-deductible contribution limit is increased by $1,000.

An HSA can generally be set up at a bank, insurance company, or other institution the IRS deems suitable. The HSA must be established exclusively for the purpose of paying the account beneficiary's qualified medical expenses. These include uninsured medical costs incurred for the account beneficiary, spouse, and dependents. However, for HSA purposes, health insurance premiums don't qualify. ■

DOUBLE DUTY GIVING WITH CHARITABLE GIFT ANNUITIES

If you are charitably inclined, you may wish to consider contributing to a charitable gift annuity, which can combine the benefits of an immediate income tax deduction and a lifetime income stream. Furthermore, your future taxable estate will be reduced for the remainder value of the property transferred to the charity.

A *charitable gift annuity* is an arrangement in which you make a gift of cash or other property to a charity in exchange for a guaranteed income annuity for life. This is similar to buying an annuity in the commercial marketplace, except that you can claim an immediate charitable deduction (subject to a 50% adjusted gross income limitation) for the excess of the value of the property over the value of the annuity, based on IRS tables. The charity must receive at least 10% of the initial net value of the property transferred in order for you to claim a charitable deduction for a portion of the purchase price.

The annuity may be payable to you over your life, or over the joint lives of you and someone you have designated. The rate of return is typically set at the time of the gift based on your age at that time. A portion of each annuity payment is tax-free, because you're entitled to recover your original investment over your life expectancy.

The amount of your charitable deduction depends on a combination of your age and an IRS-prescribed interest rate at the time of your purchase. Of course, your charitable deduction will be less than the total value of your annuity purchase price because your deduction can only be claimed for the present value of the property that the charity will keep after your death, based on your life expectancy at the time of purchasing the annuity. ■

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