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Tax & Business Alert

JULY 2014

DO YOU NEED TO ADJUST YOUR FEDERAL INCOME TAX WITHHOLDING AMOUNT?

With over half the year already gone, now is a good time to check to see if you are on track to have about the right amount of federal income tax withheld from your paychecks for 2014. The problem with not having the correct amount of taxes withheld for the year is that—

- If your taxes are significantly underwithheld for the year, you risk being hit with a nondeductible IRS interest rate penalty.
- If your taxes are significantly overwithheld for the year, you are basically making an interest-free loan to the government when you could be putting that money to work for you.

Neither situation is good. The simplest way to correct your withholding is by turning in a new Form W-4 (Employee's Withholding Allowance Certificate) to your employer. Taking this action now will adjust the amount of federal income tax that is withheld from your paychecks for the rest of 2014.

Specifically, you can adjust your withholding by increasing or decreasing the number of allowances claimed on your Form W-4. The more allowances claimed, the lower the withholding from each paycheck; the fewer allowances claimed, the greater the withholding. If claiming zero allowances for the rest of the year would still not result in enough extra withholding, you can ask your employer to withhold an additional amount of federal income tax from each paycheck.

While filling out a new Form W-4 seems like something that should be quick and easy, it's not necessarily so—because the tax rules are neither quick nor easy. Fortunately, there is an online Form W-4 calculator on the IRS website at *www.irs.gov* that can help to make the job simpler. From the IRS home page, click on the "More…" link under "Tools." Then click on the "IRS withholding calculator" link. You will see the entry point for the online calculator. It's pretty easy to use once you assemble information about your expected 2014 income and expenses, plus your most recent pay stub and tax return.

Please understand that the IRS calculator is not perfect. (Remember, it's free, and to some extent, you always get what you pay for.) However, using the calculator to make withholding allowance changes on a new Form W-4 filed with your employer is probably better than doing nothing, especially if you believe you are likely to be significantly underwithheld or overwithheld for this year.

Of course, if you want more precise results, we would be happy to put together a 2014 tax projection for you. At the same time, we can probably recommend some planning strategies to lower this year's tax bill. Contact us for details. ■

COMPARING TAXABLE VERSUS TAX-EXEMPT INVESTMENT YIELDS

With rising tax rates, some taxpayers are considering allocating at least a portion of their investments to tax-exempt investments. After all, interest earned on tax-exempt investments not only escapes ordinary income tax rates that can be as high as 39.6%, but also the 3.8% net investment income tax (NIIT).

There are lots of things to consider when making an investment, but when comparing taxable investments to tax-exempt investments, one important factor is the after-tax return. A fairly straightforward formula can be used to compare yields for taxable versus tax-exempt investments if you know your income tax bracket.

Say you are in the 43.4% federal income tax bracket (including NIIT), so an additional dollar of taxable income would cost you 43.4 cents in additional tax. You have learned of an investment opportunity that offers a 3% tax-exempt yield. You want to know how this compares effectively with your taxable investment opportunities.

1. Subtract your tax bracket from 1. This equals 0.566 (1 minus 0.434).
2. Divide the tax-exempt yield (3%) by the figure arrived at above (.566).

The result is 5.3%. This means that you would need to earn 5.3% on your taxable investment to equal the 3% you would earn on the tax-exempt one.

If you know the taxable yield, but seek a comparable tax-free yield, the computation is even easier. Simply subtract your tax bracket from 1 and multiply the result by the taxable yield. That is, if you are in the 43.4% bracket, you will keep 56.6% of your income. Thus, a taxable 4% yield translates into an after-tax yield of 2.26% (4% × 0.566).

Of course, these computations only take the federal income tax into consideration. If your income is subject to state or local taxation that the tax-exempt income avoids as well, you would have to use your total effective tax rate in your calculations to arrive at a more precise result. There may be other adjustments to make as well, so if you seek greater precision, give us a call and we will run some more exact numbers for you. ■

TAX CALENDAR

July 15

- If the monthly deposit rule applies, employers must deposit the tax for payments in June for social security, Medicare, withheld income tax, and nonpayroll withholding.

July 31

- If you have employees, a federal unemployment tax (FUTA) deposit is due if the FUTA liability through June exceeds $500.
- The second quarter Form 941 (Employer's Quarterly Federal Tax Return) is also due today. (If your tax liability is less than $2,500, you can pay it in full with a timely filed return.) If you deposited the tax for the quarter in full and on time, you have until August 11 to file the return.

August 15

- If the monthly deposit rule applies, employers must deposit the tax for payments in July for social security, Medicare, withheld income tax, and nonpayroll withholding.

September 15

- Third quarter estimated tax payments are due for individuals, trusts, and calendar-year corporations.
- If a five-month extension was obtained, partnerships should file their 2013 Form 1065 by this date.
- If a six-month extension was obtained, calendar-year corporations should file their 2013 income tax returns by this date.
- If the monthly deposit rule applies, employers must deposit the tax for payments in August for social security, Medicare, withheld income tax, and nonpayroll withholding.

GETTING AROUND THE $25 DEDUCTION LIMIT FOR BUSINESS GIFTS

Sometimes doing business entails making gifts to customers, clients, employees, and other business entities and associates. For numerous reasons, such gifts often make perfect business sense. Unfortunately, the tax rules limit the deduction for business gifts to a less-than-generous $25 per person per year—a limitation that hasn't been raised in decades. When this limit was added into law back in 1962, the $25 gift deduction limit wasn't really an issue for any but the most extravagant taxpayers. After all, the price of a first class stamp at the time was 4¢ and a 100% wool men's suit could be had for $45 or less.

Fifty-two years later, the $25 limit is unrealistically small in many business gift-giving situations. Fortunately, there are a few exceptions to this rather restrictive limit. When one of these exceptions applies, you typically have no limit (or at least, a much higher limit) on the deduction for business gifts.

Here's a quick rundown of the major exceptions to the $25 limit.

Gifts to a Business Entity versus an Individual. The $25 limit only applies to gifts directly or indirectly given to an individual. Thus, gifts given to a company for use in the business aren't subject to the limit. For example, a gift of a $200 reference manual to a company for its employees to use while doing their jobs would be fully deductible because it's used in the company's business.

Although employee gifts have their own limitations and may be treated as compensation, an employer is allowed to deduct the full cost of gifts made to employees.

Gifts to a Husband and Wife. If you have a business connection with both spouses and the gift is for both of them, the $25 limit doubles to $50.

Only Direct Costs Are Limited. The incidental costs of making a gift aren't subject to the limit. Thus, the costs of custom engraving on jewelry, and the costs of packing, insuring, and mailing a gift are deductible over and above the $25 limit for the gift itself.

Gifts to Employees. Although employee gifts have their own limitations and may be treated as compensation, an employer is allowed to deduct the full cost of gifts made to employees.

Gifts versus Entertainment Expenses. Entertainment expenses are normally only 50% deductible and gifts, of course, are typically 100% deductible, but only up to the first $25 of cost per donee per year. In some situations related to gifts of tickets to sporting and other events, a taxpayer may choose whether to claim the deduction as a gift or as entertainment. The gift deduction is a better deal for lower-priced tickets, but once the combined price of the gifted tickets exceeds $50, claiming them as an entertainment expense is more beneficial.

As you can see, there are several exceptions to the $25 rule, so many businesses will be able to meet at least one of them. To the extent your business qualifies for any of these exceptions, it's important that the qualifying expenses be tracked separately (typically by charging them to a separate account in your accounting records) so that a full deduction can be claimed.

Also, to obtain any deduction for a business gift, even the miserly $25 gift deduction, you must retain documentation supporting the following: (1) the gift's cost and a description of it, (2) the date it was acquired, (3) the business purpose of the gift, and (4) the business relationship to the taxpayer of the person receiving the gift.

If you have any questions regarding the types of gifts or gift-giving situations that may qualify for a full deduction or how to properly isolate and account for them in your records, please call us so we can help you get to the right answers. ■

IRS PHONE SCAM WARNING

The IRS has issued a warning about a pervasive phone scam. The Treasury Inspector General for Tax Administration (TIGTA) called it the largest scam of its kind. It has received reports of over 20,000 contacts related to this scam, and thousands of victims have paid over $1 million to fraudsters claiming to be from the IRS.

In this scam, the thief poses as an IRS agent and makes an unsolicited call to the target. The caller tells the victim that he or she owes taxes to the IRS. The caller demands that the victim pay the money immediately with a pre-loaded debit card or wire transfer. The caller often threatens the victim with arrest, deportation, or suspension of a business or driver's license. In many cases, the caller becomes hostile and insulting. Thieves who run this scam often:

- Use common names and fake IRS badge numbers.
- Know the last four digits of the victim's Social Security Number.
- Make caller ID appear as if the IRS is calling.
- Send bogus IRS e-mails to support the bogus calls.
- Call a second time claiming to be the police or department of motor vehicles. The caller ID again appears to support their claim.

You should know that the IRS usually first contacts people by mail, not by phone, about unpaid taxes. Most importantly, an IRS agent will never ask for:

- PINs, passwords, or similar confidential information for credit card, bank, or other accounts.
- Payment using a prepaid debit card or wire transfer.
- A credit card number over the phone.

If you get a call from someone who claims to be with the IRS asking you to pay back taxes, hang up.

If you owe or think you might owe federal taxes, call the IRS at (800) 829-1040 or call us for help. If you don't owe taxes, call and report the incident to the TIGTA at (800) 366-4484. ■