Long, Cook & Samsa, Inc.
Certified Public Accountants/Consultants
505 N. Market St., P.O. Box 58
Wooster, Ohio 44691

Gregory A. Long, CPA
John P. Cook, Ph.D., CPA

(330)262-7111 • (330)262-5995
Fax (330)264-7554
E-mail CPA@LCS-CPA.COM

Tax & Business Alert

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AMT AWARENESS: BE READY FOR ANYTHING

When it comes to tax planning, you've got to be ready for anything. For example, do you know whether you're likely to be subject to the alternative minimum tax (AMT) when you file your 2016 return? If not, you need to find out now so that you can consider taking steps before year end to minimize potential liability.

BIGGER BITE

The AMT was established to ensure that high-income individuals pay at least a minimum tax, even if they have many large deductions that significantly reduce their "regular" income tax. If your AMT liability is greater than your regular income tax liability, you must pay the difference as AMT, in *addition* to the regular tax.

AMT rates begin at 26% and rise to 28% at higher income levels. The maximum rate is lower than the maximum income tax rate of 39.6%, but far fewer deductions are allowed, so the AMT could end up taking a bigger tax bite.

For instance, you can't deduct state and local income or sales taxes, property taxes, miscellaneous itemized deductions subject to the 2% floor, or home equity loan interest on debt not used for home improvements. You also can't take personal exemptions for yourself or your dependents, or the standard deduction if you don't itemize your deductions.

STEPS TO CONSIDER

Fortunately, you may be able to take steps to minimize your AMT liability, including:

Timing capital gains. The AMT exemption (an amount you can deduct in calculating AMT liability) phases out based on income, so realizing capital gains could cause you to lose part or all of the exemption. If it looks like you could be subject to the AMT this year, you might want to delay sales of highly appreciated assets until next year (if you don't expect to be subject to the AMT then) or use an installment sale to spread the gains (and potential AMT liability) over multiple years.

Timing deductible expenses. Try to time the payment of expenses that are deductible for regular tax purposes but not AMT purposes for years in which you don't anticipate AMT liability. Otherwise, you'll gain no tax benefit from those deductions. If you're on the threshold of AMT liability this year, you might want to consider delaying state tax payments, as long as the late-payment penalty won't exceed the tax savings from staying under the AMT threshold.

DOES THIS SOUND FAMILIAR?

High-income earners are typically most susceptible to the alternative minimum tax. But liability may also be triggered by:

- A large family (meaning you take many exemptions),
- Substantial itemized deductions for state and local income taxes, property taxes, miscellaneous itemized deductions subject to the 2% floor, home equity loan interest, or other expenses that aren't deductible for AMT purposes,
- Exercising incentive stock options,
- Large capital gains,
- Adjustments to passive income or losses, or
- Interest income from private activity municipal bonds.

Investing in the "right" bonds. Interest on tax-exempt bonds issued for public activities (for example, schools and roads) is exempt from the AMT. You may want to convert bonds issued for private activities (for example, sports stadiums), which generally don't enjoy the AMT interest exemption.

APPROPRIATE STRATEGIES

Failing to plan for the AMT can lead to unexpected — and undesirable — tax consequences. Please contact us for help assessing your risk and, if necessary, implementing the appropriate strategies for your situation. ■

5 TIPS FOR SAFE INTRAFAMILY LOANS

If a relative needs financial help, offering an intrafamily loan might seem like a good idea. But if not properly executed, such loans can carry substantial negative tax consequences — such as unexpected taxable income, gift tax or both. Here are five tips to consider:

1. Create a paper trail. In general, to avoid undesirable tax consequences, one thing you'll need to do is show that the loan was bona fide. Doing so should include documenting evidence of:

- The amount and terms of the debt,
- Interest charged,
- Fixed repayment schedules,
- Collateral,
- Demands for repayment, and
- The borrower's solvency at the time of the loan and payments made.

Be sure to make your intentions clear — and help avoid loan-related misunderstandings — by documenting the loan and payments received, as well.

2. Demonstrate an intention to collect. Even if you think you may eventually forgive the loan, ensure the borrower makes at least a few payments. By having some repayment history, you'll make it harder for the IRS to argue that the loan was really an outright gift. And if a would-be borrower has no realistic chance of repaying a loan — don't make it. If you're audited, the IRS is sure to treat such a loan as a gift.

3. Charge interest if the loan exceeds $10,000. If you lend more than $10,000 to a relative, charge at least the applicable federal interest rate (AFR). In any case, the interest on the loan will be taxable income to

you. (If no or below-AFR interest is charged, taxable interest is calculated under the complicated below-market-rate loan rules.) However, if no or below-AFR interest is charged, all of the forgone interest over the term of the loan may have to be treated as a gift in the year the loan is made. This will increase your chances of having to use some of your lifetime exemption.

4. Use the annual gift tax exclusion. If you want to, say, help your daughter buy a house but don't want to use up any of your lifetime estate and gift tax exemption, make the loan, charge interest and then forgive the interest, the principal payments or both each year under the annual gift tax exclusion. For 2016, you can forgive up to $14,000 per borrower ($28,000 if your spouse joins in the gift) without paying gift taxes or using any of your lifetime exemption. But you will still have interest income in the year of forgiveness.

5. Forgive or file suit. If an intrafamily loan that you intended to collect is in default, don't let it sit too long. To prove this was a legitimate loan that soured, you'll need to take appropriate legal steps toward collection. If you know you'll never collect and can't bring yourself to file suit, begin forgiving the loan using the annual gift tax exclusion, if possible. ■

FUNDING A COLLEGE EDUCATION? DON'T FORGET THE 529

When 529 plans first hit the scene, circa 1996, they were big news. Nowadays, they're a common part of the college-funding landscape. But don't forget about them — 529 plans remain a valid means of saving for the rising cost of tuition and more.

FLEXIBILITY IS KING

529 plans are generally sponsored by states, though private institutions can sponsor 529 prepaid tuition plans. Just about anyone can open a 529 plan. And you can name anyone, including a child, grandchild, friend, or even yourself, as the beneficiary.

Investment options for 529 savings plans typically include stock and bond mutual funds, as well as money market funds. Some plans offer age-based portfolios that automatically shift to more conservative investments as the beneficiaries near college age.

Earnings in 529 savings plans typically aren't subject to federal tax, so long as the funds are used for the beneficiary's qualified educational expenses. This can include tuition, room and board, books, fees, and computer technology at most accredited two- and four-year colleges and universities, vocational schools, and eligible foreign institutions.

Many states offer full or partial state income tax deductions or other tax incentives to residents making 529 plan contributions, at least if the contributions are made to a plan sponsored by that state.

You're not limited to participating in your own state's plan. You may find you're better off with another state's plan that offers a wider range of investments or lower fees.

THE DOWNSIDES

While 529 plans can help save taxes, they have some downsides. Amounts not used for qualified educational expenses may be subject to taxes and penalties. A 529 plan also might reduce a student's ability to get need-based financial aid, because money in the plan isn't an "exempt" asset. That said, 529 plan money is generally treated more favorably than, for instance, assets in a custodial account in the student's name.

Just like other investments, those within 529s can fluctuate with the stock market. And some plans charge enrollment and asset management fees.

Finally, in the case of prepaid tuition plans, there may be some uncertainty as to how the benefits will be applied if the student goes to a different school.

WORK WITH A PRO

The tax rules governing 529 savings plans can be complex. So please give us a call. We can help you determine whether a 529 plan is right for you. ■

BARTERING BUSINESSES CAN'T CUT UNCLE SAM OUT OF THE DEAL

Bartering may seem like something that happened only in ancient times, but the practice is still common today. And the general definition remains the same: the exchange of goods and services without the exchange of money.

Because, in a typical barter transaction, no cash exchanges hands, it's easy to forget about taxes. But, as one might expect, you can't cut Uncle Sam out of the deal. The IRS treats a barter exchange the same as a transaction, so you must report the fair market value of the products or services you receive as income.

Any income arising from a bartering arrangement is generally taxable in the year you receive the bartered product or service. And income tax liability isn't the only thing you'll need to consider. Barter activities may also trigger self-employment taxes, employment taxes or an excise tax.

You may wish to arrange a bartering deal though an exchange company. For a fee, one of these firms can allow you to network with other businesses looking to trade goods and services. For tax purposes, a barter exchange typically must issue a Form 1099-B, "Proceeds from Broker and Barter Exchange Transactions," annually to its clients or members.

Although bartering may appear cut and dried, the tax implications can complicate the deal. We can help you assess a bartering arrangement and manage the tax impact. ■

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