focus

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zinner&co.

Certified Public Accountants and Management Consultants

3201 Enterprise Parkway, Suite 410 • Beachwood, OH 44122
ph: 216.831.0733 • fax: 216.765.7118
info@zinnerco.com • www.zinnerco.com

MISCELLANEOUS ITEMIZED DEDUCTIONS

What you can — and can't — deduct

Most taxpayers are very familiar with itemized deductions related to home ownership, medical expenses and charitable donations. But many are less familiar with miscellaneous itemized deductions. If, for example, you must belong to a trade or professional association to carry out your job responsibilities, yet your employer doesn't cover the dues, you may be able to deduct the amount on your tax return. This is just one of a number of available miscellaneous itemized deductions.

Miscellaneous itemized deductions are divided into two broad categories. The first includes those that can be deducted to the extent the total exceeds 2% of your adjusted gross income (AGI). The other group, not surprisingly, consists of deductions that aren't subject to the 2% floor. Do you know what miscellaneous expenses you can deduct — and what you can't?

Deductions subject to the 2% floor

The IRS further classifies deductions subject to the 2% floor into three groups. One is unreimbursed employee expenses. To qualify for the deduction, the expenses must be ordinary and necessary, such as business liability insurance premiums and dues to chambers of commerce, trade and professional associations or civic organizations.

Home office expenses, such as telecommunication services, can also qualify, so long as the space is used regularly and exclusively for work and is a requirement of your employment. (Self-employed taxpayers can deduct qualified home office expenses directly from their self-employment income; the expenses aren't treated as a miscellaneous itemized deduction and thus aren't subject to the 2% floor.)

The second group of expenses subject to the 2% floor consists of fees for tax preparation and tax advice. You can deduct these expenses for the year in which you pay them. So, on your 2014 return, you can deduct fees paid in 2014 for preparing your 2013 return. This can include the costs of tax preparation software as well as any charges for filing your return electronically.

The third group that's subject to the 2% floor includes a variety of "other expenses." Among them are:

- Expenses you might have incurred to produce or collect the income that's included in your gross income,
- Costs incurred to determine, contest, pay or claim a refund of any tax,
- The cost of any help — whether professional or clerical — needed to care for your investments, and
- Any fees you were charged to collect interest and dividends.

Keep in mind that you'll need to keep track of such expenses in order to get a deduction on your tax return.

What's *not* subject to the 2% rule

There's a range of expenses that can be taken as miscellaneous itemized deductions regardless of whether they exceed 2% of your AGI. These expenses can include casualty and theft losses from income-producing properties, such as stocks, bonds, works of art and vacant lots.

They also include the federal estate tax attributable to "income in respect of a decedent." This is gross income a deceased person would have received if he or she hadn't passed away and that you, as a beneficiary, include in your gross income.

Expenses that can't be deducted

Some expenses that you might think would qualify as miscellaneous itemized deductions actually don't, such as:

- Adoption expenses,
- Brokers' commissions,
- Burial or funeral expenses,
- Commuting expenses,
- The cost of meals eaten while working late or with co-workers,
- Personal legal expenses, and
- Professional accreditation fees.

Some of these expenses may, however, make you eligible for other tax benefits. For instance, adoption expenses may qualify for a tax credit.

The best source for guidance

Determining which miscellaneous expenses *are* deductible and which *aren't* can get confusing. For instance, license and regulatory fees you pay to state and local governments for your trade, business or profession are deductible, subject to the 2% limit. However, professional accreditation fees, such as bar exam fees paid to secure initial admittance to the bar, aren't deductible.

Your tax advisor is the best source for guidance on what miscellaneous itemized deductions you may be eligible for. ◈

Miscellaneous itemized deductions and the AMT

While most miscellaneous itemized deductions are welcomed by taxpayers who would like to hand over fewer dollars to Uncle Sam, they're not always useful. Taxpayers who end up owing the alternative minimum tax (AMT) generally won't get any federal tax benefit from the miscellaneous itemized deductions that are subject to the 2% floor. There may be situations, however, where the tax benefit is reduced without being completely eliminated.

The AMT was established by Congress to prevent high-income taxpayers from escaping their responsibility to pay federal income tax by, among other tactics, taking very large amounts of deductions. Since its enactment in 1969, many taxpayers have had to run parallel calculations — one for the regular tax and one for the AMT — and pay whichever tax amount is higher.

Because of the way the AMT is calculated, it's typically triggered not just by taxpayers' income levels, but also by the types and levels of income and deductions. And, in calculating AMT income, taxpayers are required to add back the deduction allowed under regular tax purposes for the miscellaneous itemized deductions subject to the 2% floor.

Of course, even if a deduction isn't allowed for federal income tax purposes, it still may be allowed on your state tax return. Most (although not all) states don't have an AMT calculation.

Oops … My family business chose the wrong successor

Hopefully, your family business has chosen a great successor. But if you're in the midst of training your successor — or even beginning to hand off the reins — and regretting your choice, how can you take a bad situation and turn it around? There are several options you might want to consider.

Bring in a family business consultant

Before you "fire" your chosen successor, discuss the matter with your board of directors and an objective party, such as a trusted advisor or a family business consultant. After all, it's possible that your perception may be off the mark.

You may think, for instance, that your successor lacks the necessary skills to run your company. But, in reality, he or she may simply have a different leadership style than you do. Talking about the situation will help you determine what went awry — or if the successor actually is the right person after all.

Solicit input from your successor. He or she may be aware of the problems and might even have started fixing them.

Get to the bottom of the problem

If you believe that — with a little work — your successor is capable of running the business effectively, talk with him or her. Be clear about your concerns and outline what must change before he or she can take over. And don't forget to solicit input from your successor. He or she may be aware of the problems and might even have started fixing them.

Also, make sure you discover why your successor is having difficulties. Perhaps he or she lacks formal training in a particular aspect of the job. In such cases, a community college course or even just more mentoring from you might solve the problem.

Or your successor may be facing personal issues that are getting in the way of work. For example, he or she may be going through tough times with a spouse or other loved one, battling an addiction, or facing financial problems. By listening, you can find out what the issues are, and you may be able to help your successor address them.

Know when it's time for a change

After talking with your advisor and, perhaps, your chosen successor, you may still feel the successor needs to go — or even discover that he or she no longer wants to take over your family business. If you decide to choose someone else, let your successor know as soon as possible and explain why things won't work. Being honest will help you keep personal ties intact.

As you resolve matters with your former successor, reconstruct the succession process to determine what promises you made and how you communicated them. Review memos and talk with your managers and your ex-successor to discover any areas you could have handled differently.

Additionally, if you haven't done so already, develop objective criteria for your next successor. Once you pick a new leader, discuss what went wrong with your first choice and why your expectations changed.

To keep operations running smoothly and safeguard your family business, create an exit strategy and explain the situation to employees. The amount of information you share with your staff will depend in part on how much you've already communicated to them.

And finally, if your second choice also doesn't work out, stay open to the possibility that the problem may not have been with your successors. It's possible that *you* fell short of communicating important expectations or failed to spend enough time training your candidates.

Start a new chapter

Everyone makes mistakes. So, if you've made the mistake of choosing the wrong successor, learn from it and move forward. Just be certain that you work closely with your business advisors. Doing so will help you avoid making another mistake when choosing a new successor. ◈

Are you classifying your employees correctly?

How can you tell if you're correctly classifying employees as exempt or hourly? Exempt employees, unlike their nonexempt hourly counterparts, aren't subject to the minimum wage and overtime pay requirements of the Fair Labor Standards Act (FLSA). However, exempt positions must meet certain requirements set by the Department of Labor (DOL).

This area of regulation gives rise to a number of misperceptions, such as the idea that job titles determine whether jobs are exempt from overtime or minimum wage laws. Breaking through the confusion and getting this responsibility right is critical, because incorrect employee classifications can expose your company to significant fines, legal action and negative publicity.

Some background

The FLSA requires most employees in the United States to be paid at least the federal minimum wage for all hours they work, plus overtime pay for hours worked over 40 in a workweek. The FLSA provides exemptions from these requirements for employees in some executive, administrative, professional, outside sales and computer positions. These often are referred to as "exempt" positions. To be considered exempt, however, the positions must meet a number of criteria.

For instance, an executive exemption requires that an employee's primary duty consist of

managing an enterprise or one of its recognized departments or subdivisions. He or she must regularly direct the work of at least two other full-time equivalent employees.

An exempt executive also must have the authority to either hire or fire employees, or have his or her recommendations regarding hiring, firing and promoting other employees be given particular weight. Finally, he or she must make at least $455 per week on a salary basis. Of special note, paying an exempt executive on an hourly basis instead of a salary basis voids the exemption, creating significant exposure.

Exempt administrative positions also need to meet certain criteria. For example, in addition to being paid at least $455 per week on a salary *or fee* basis, the DOL states that, to be exempt, administrative employees must be able to "exercise discretion and independent judgment with respect to matters of significance…."

If exempt employees are ready, willing and able to work, they can't have their pay cut just because no work is available.

The DOL breaks professional employees into two categories — learned and creative — for the purpose of determining whether they're exempt. Learned professionals' work is predominantly intellectual in character and requires a consistent exercise of discretion and judgment. Creative professional employees' primary work requires "invention, imagination, originality or talent." Like administrative employees, professional employees must be paid at least $455 per week on a salary or fee basis.

Additional requirements

Several other requirements come into play with exempt employees. Barring a few exceptions, exempt employees must receive their full pay for any weeks in which they've performed work, no matter how many hours or days they work.

If exempt employees are ready, willing and able to work, they can't have their pay cut just because no work is available. Employers who improperly deduct pay from exempt employees' salaries risk losing these employees' exempt status.

Positions matter

Exemptions aren't allowed with a number of positions, including manual laborers and nonmanagement employees in production, maintenance, technical, construction and similar occupations. These workers are covered by the minimum wage and overtime pay provisions of the FLSA, no matter how highly paid they are.

The FLSA also requires employers to maintain certain records for their nonexempt employees. These must include the hours they work daily and within a workweek, as well as the rate or basis of pay and terms of compensation.

Do good by your employees

Determining which jobs are exempt and which aren't can get complicated, as such decisions often turn on specific job duties. Moreover, the burden of proving that a position is exempt rests with employers. So make sure you review the FLSA's requirements and the DOL rules, along with any state or local employment laws and regulations. Also be sure to consult a legal or HR professional when determining employees' classifications. ◈

Watch out!

There are new rules regarding excepted benefits

Does your company offer dental, vision, long-term care or employee assistance plans? If it does, pay attention to new regulations jointly issued by the IRS, the Department of Labor, and the Department of Health and Human Services. The new rules should make these plans more attractive to both employers and employees.

Limited excepted benefits

The regs address limited excepted benefits, which are separate from employers' group health plans. These benefits often include limited-scope dental and vision plans, as well as benefits for long-term care, nursing home care and home health care.

The "excepted" status is key, because excepted benefits aren't subject to some of the portability and nondiscrimination requirements of the Health Insurance Portability and Accountability Act (HIPAA) and the Affordable Care Act. In addition, employees who are eligible to participate in excepted plans aren't precluded from receiving tax credits for their insurance premiums if they obtain health care coverage through a health insurance exchange.

The change

Before the rules were enacted, employers had to collect contributions from participants before their limited-scope vision or dental plans or their long-term care benefits could qualify as excepted. However, as the agencies stated, "In some cases, the cost of collecting the nominal contribution would be greater than the contribution itself."

The agencies removed the requirement that plan participants pay an additional premium or contribution before limited benefit plans could qualify as excepted. The IRS also said limited-scope vision or dental benefits don't have to be offered in connection with a major medical or primary group health plan to be considered excepted.

An EAP's benefits can't be coordinated with the benefits available under another group health plan.

In addition, the new rules establish four criteria under which employee assistance plans (EAPs) can be considered as excepted benefit plans. First, EAPs can't provide significant health care benefits. "Significant" is determined by the amount, scope and duration of the benefits offered. For instance, an EAP that provides disease management services for individuals with chronic conditions likely wouldn't qualify as an excepted benefit plan.

In addition, an EAP's benefits can't be coordinated with the benefits available under another group health plan, and employees can't be required to provide contributions or pay premiums to participate in the EAP. Finally, the EAP can't impose any cost-sharing requirements.

Are you ready?

The new rules kick in for plan years beginning on or after Jan. 1, 2015, so make sure you contact your benefits advisor. He or she can offer additional insight on excepted benefits and the impact of these rules. ◈

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The **right ideas**
The **right results**
Achieved with the **right firm**

ARE FAMILY DYNAMICS HARMING THE FAMILY BUSINESS?

One of the biggest obstacles impeding the growth of a family business may be the family itself.

Family dynamics can have a negative impact on a small business. An internal tug-of-war can prevent goals from being attained, increases turnover, and creates a hostile work environnment. The impact also spreads to non-family employees, decreasing their overall motivation and ability to lead. As experts in family succession planning, Zinner & Co. can help identify internal problems and design strategies focused around growth.

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Zinner & Co. provides advisory services that help ensure that the accumulated value of a business remains intact after its owner's eventual departure.

Plan today to ensure that the business you built continues to thrive in the hands of your successors.

gsigman@zinnerco.com
3201 Enterprise Parkway
Suite 410
Beachwood, Ohio 44122
216.831.0733

www.zinnerco.com