George Johnson & Company
Certified Public Accountants and Consultants

Informer

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Spring/Summer 2014 Issue

Dear Clients and Friends,

I think it's finally safe to store away my winter coat…thank goodness! After a long, frigid and relentless winter, I'm embracing spring! Seeing the buds sprouting from the ground brings me great joy! It's also a reminder of another tax season in full effect.

Before we talk taxes, let me mention that this past January, to commemorate Dr. Martin Luther King, Jr., our team, in conjunction with City Year Detroit, volunteered at the Kiwanis Club Books for Kids community event. In the warehouse, our team organized and stickered over a thousand books donated to children and schools in the Detroit metropolitan area.

Getting back to taxes, this Informer will highlight tax tips and important information as you tax plan throughout the year. After reading the *Informer*, please call if you have questions or if you would like to get together to discuss your taxes.

We, at George Johnson & Company, are committed to our clients. I am grateful and proud of our GJC team efforts as we work through another busy period. Albert Einstein may have said, *"The hardest thing in the world to understand is income tax."* But I say, that is why George Johnson & Company is glad to be here!

All the best,
George

On behalf of our team at GJC,

Happy Spring!

"The hardest thing in the world to understand is income tax."

-Albert Einstein

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NOTE: This newsletter is issued to provide you with information about minimizing your taxes. Do not apply this general information to your specific situation without additional details. Be aware that the tax laws contain varying effective dates and numerous limitations and exceptions that cannot be summarized easily. For details and guidance in applying the tax rules to your individual circumstances, please contact us.

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PAY ATTENTION TO YOUR MAGI (MODIFIED ADJUSTED GROSS INCOME) TO QUALIFY FOR TAX BREAKS

Take a look at your 2013 tax return after it's prepared. How close to the edge did you come to losing tax benefits due to tax phase-outs? As you begin your 2014 tax planning, consider the effects of these benefit-limiting provisions, many of which are based on **modified adjusted gross income**, or MAGI. Knowing how close you are to the "edge" can help you preserve tax breaks for 2014.

A caution: Since the definition of MAGI as applicable to individual phase-outs varies, you might have to choose between conflicting opportunities. For instance, if you have a child in college this semester, the American Opportunity Credit and the Lifetime Learning Credit may be on your mind. Both benefits are education-related, yet the qualifying requirements differ – including the MAGI threshold.

- **Education benefits.** The American Opportunity Credit is a partially refundable, dollar-for-dollar reduction of your tax bill, with a maximum of $2,500 per student. This year the credit starts to shrink when your MAGI reaches $160,000 and you're married filing jointly ($80,000 when you're single). It disappears completely when your MAGI is greater than $180,000 for joint returns, and $90,000 when your filing status is single.

For 2014, the Lifetime Learning Credit begins to phase out at $108,000 when you're married filing a joint return and $54,000 when you're single. Once your MAGI reaches $128,000 (married) or $64,000 (single), the credit is no longer available.

Other education benefits, such as the above-the-line tuition and fees deduction, also have MAGI limitations. If you qualify, you can claim the maximum annual limit of $4,000 when you're married filing jointly and your MAGI does not exceed $130,000 ($65,000 if you're single). The deduction phases out completely when your income reaches $160,000 ($80,000 for singles).

- **Retirement plans.** Phase-outs affect retirement planning too. The deduction for contributions to your traditional IRA is limited when you are eligible to participate in your employer's plan and your MAGI exceeds $96,000 ($60,000 when you're single).

  And while Roth IRA contributions are not tax-deductible, the amount you can contribute for 2014 begins to phase out when your MAGI reaches $181,000 ($114,000 if you file single).

  In addition, the federal "saver's" credit for making contributions to retirement plans phases out when your 2014 modified adjusted gross income is more than $60,000 and your filing status is married filing jointly ($30,000 for singles).

- **Other phase-outs.** Finally, the exclusion of social security benefits from taxable income also has a phase-out calculated on the amount of your MAGI over the base amount of $32,000 when you're married and $25,000 when you're single.

  Other phase-outs affecting your 2014 federal tax return reduce personal exemptions, itemized deductions, and the alternative minimum tax exclusion. Contact our office for guidance in managing income for maximum tax breaks.

  While you're pondering equipment purchases, remember that energy-efficient assets can make your business eligible for tax deductions in addition to depreciation. When you install energy-saving air conditioning, hot water, and interior lighting systems in your eligible commercial property, you may be able to take a deduction of up to $1.80 per square foot.

Another tax management technique: Take a look at income or expense items you can shift between 2013 and 2014, such as shareholder bonuses.

To review tax-cutting options sized to your particular circumstance, contact our office.

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WHEN ARE YOU REQUIRED TO FILE A GIFT TAX RETURN?

Are you planning to give sizeable gifts to family members? Due to generous provisions in the tax code, you may not owe any federal gift tax, but you still might be required to a file a gift tax return.

Here's a quick review of the basic rules. Despite a common misconception, gift tax is paid by the gift giver, or "donor," not the recipient, or "donee." This applies to gifts of cash, property, and other interests. For 2013 and thereafter, the top gift tax rate is permanently set at 40%, a slight increase from 35% in 2012. However, you may be able to avoid gift tax liability due to two key tax breaks.

- **Annual gift tax exclusion.** Under the exclusion, annual gifts to a donee valued up to $14,000 in 2014 (the same as in 2013) are completely exempt from gift tax. Note that the exclusion is available for gifts to as many recipients as you choose.

- **Lifetime gift tax exclusion.** In addition to any amount covered by the annual gift tax exclusion, you can benefit from a lifetime gift tax exemption of $5 million, inflation-indexed to $5.34 million in 2014. However, this exemption is unified with the federal estate tax exemption, so amounts used for gifts will erode the tax shelter available for bequests from your estate.

Generally, you don't have to file a gift tax return, Form 709, for gifts covered by the annual exclusion, but you must file this form if you tap into the lifetime exemption amount. Also, when you make a "split gift" with your spouse, the annual exclusion amount is doubled to $28,000 per donee, but a gift tax return is required even if you don't owe any tax. Furthermore, if you give a gift of a "future interest," such as a transfer of assets to a trust, a gift tax return must be filed in any event.

In some cases, you might file a gift tax return when you're not legally required to. This starts the statute of limitations running on the time the IRS will have to challenge the valuation of the gift. It also discloses the gift for other purposes.

The deadline for filing federal gift tax returns is the same as the one for income tax returns. Thus, if you gave more than $14,000 to a donee in 2013, you have until April 15, 2014, to file the return, but you can apply for an automatic six-month filing extension. Caution: This extension is for filing only and not payment of any gift tax that is owed.

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TAXES AND RETIREMENT ACCOUNTS

Retirement accounts grow tax-deferred until you need the funds. However, in most cases your money cannot remain in these accounts forever. The IRS has rules that dictate when and how much you must withdraw from your retirement accounts.

- **Required withdrawals.** The amount you must withdraw each year is called your required minimum distribution (RMD). You can withdraw more than the required minimum distribution from your retirement accounts, but if you fail to take at least the required minimum on time, you face a severe 50% penalty. These rules apply to traditional IRAs and qualified retirement plans, but they do not apply to Roth IRAs during the owner's lifetime.

In most cases, you must begin withdrawing money from your retirement accounts as follows:

- Your first withdrawal can either be taken in the year you turn age 70½, or it can be postponed until April 1 of the following year.

- Your second withdrawal must be taken by December 31 of the year after you turn 70½.

- In each subsequent year, you must withdraw at least the required minimum amount by December 31.

If you're still working at age 70½ and you own less than 5% of the company you work for, you can wait until you retire to begin taking distributions from qualified plans, such as 401(k)s. This exception does not apply to traditional IRAs.

- **Income tax planning.** Your retirement fund trustee must tell the IRS whether you are required to take a minimum distribution. Because all or part of your distribution may be taxable income, it is important to include RMDs in your tax planning.

- **Estate planning.** Retirement accounts are subject to estate tax as well as income tax. If you die owning an IRA or 401(k), your plan will be considered an asset in your estate and, like every other asset, it could be subject to estate tax. And since most retirement plans contain untaxed income, your plan could also be hit with income tax when it is distributed to your heirs. Unless you want the tax man to end up with a large chunk of retirement funds left in your estate, planning is essential.

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IRS ADJUSTS TAX NUMBERS FOR 2014

Each year the IRS adjusts certain tax numbers for inflation and tax law changes. Here are some of the adjusted numbers you'll need for your 2014 tax planning.

- Standard mileage rate for business driving decreases to 56¢ a mile. Rate for medical and moving mileage decreases to 23.5¢ a mile. Rate for charitable driving remains at 14¢ a mile.
- Section 179 maximum first-year expensing deduction decreases to $25,000, with a phase-out threshold of $200,000.
- Social security taxable wage limit increases to $117,000. Retirees under full retirement age can earn up to $15,480 without losing benefits.
- Kiddie tax threshold remains at $2,000 and applies up to age 19 (up to age 24 for full-time students).
- Nanny tax threshold increases to $1,900.
- Health savings account (HSA) contribution limit increases to $3,300 for individuals and to $6,550 for families. An additional $1,000 may be contributed by those 55 or older.
- 401(k) maximum salary deferral remains at $17,500 ($23,000 for 50 and older).
- SIMPLE maximum salary deferral remains at $12,000 ($14,500 for 50 and older).
- IRA contribution limit remains at $5,500 ($6,500 for 50 and older).
- Estate tax top rate remains at 40%, and the exemption amount increases to $5,340,000.
- The annual gift tax exclusion remains at $14,000.
- Tax credit for adopting a child is $13,190 for 2014.
- Alternative minimum tax exemption amounts increase to $52,800 for single taxpayers and $82,100 for married couples filing a joint return.
- Limit on transportation fringe benefit is $130 for vehicle/transit passes and $250 for qualified parking.

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CHECK YOUR ELIGIBILITY FOR THIS BUSINESS CREDIT

The health insurance premium credit for small businesses has been available since 2010. According to a recent report, many businesses that qualify for this credit have failed to take it.

Even if your business hasn't taken this credit in the past, you may want to look into it this year. For 2014, the credit increases from 35% to 50%. When you qualify, you can use the credit to offset your federal income tax liability by up to 50% of the cost of health insurance premiums you pay for employees.

The three general tests for eligibility are listed below. Each test has specific requirements. For example, you may qualify for the credit, in full or in part, when you have more than 25 employees. That's because "full-time equivalent" is based on hours your employees worked during the year.

In addition, some employees aren't counted for purposes of the credit, such as seasonal staff who were on the payroll for less than 120 days. Other excluded workers are sole proprietors, owner/employees, and shareholders who own more than 2% of the stock of an S corporation.

For assistance in reviewing your eligibility for the credit, contact our office.

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Three general tests for eligibility are:

- Employing fewer than 25 "full-time equivalent" employees.
- Paying average annual wages of less than $50,000.
- Paying at least 50% of health insurance premiums for those employees.

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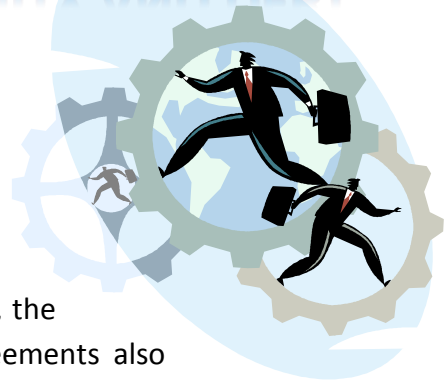
TWO FINANCING OPTIONS FOR YOUR BUSINESS: EQUITY AND DEBT

Start-up businesses and long-established firms share common ground in at least one respect: the need for financing. Managers of fledgling companies often debate the best way to obtain funds for buying inventory, heavy equipment, and buildings for making widgets. In the break rooms and suites of Fortune 500 firms, executives also discuss the best ways to cover cash shortfalls and meet capital needs.

Business financing generally comes in two flavors: equity and debt. For small businesses, equity financing often takes the form of contributions by family members, friends, business associates, and investors. For business owners, the biggest drawback to equity financing is loss of control. If Uncle John pumps his savings into your newly formed company, he may want a substantial voice in its day-to-day operations, whether or not he understands your industry or business model. On the plus side, equity contributions may be easier to procure than bank loans or other forms of financing.

Without an established track record, businesses may struggle to obtain debt financing. To extend a loan, a lender must be willing to risk the institution's funds on your business. Loan terms generally compensate for this risk by stipulating an interest rate that reflects the lender's estimate of your credit worthiness. If the lender thinks your firm may struggle making the loan payments, expect a higher rate.



From a business owner's perspective, the signing of loan agreements also carries risk. That's why it's wise to proceed slowly. Take time to develop a formal business plan, cash flow projections, and a realistic picture of the firm's needs. Determine whether alternate forms of financing may be available. Remember that failure to make timely loan payments may adversely affect your company's ability to obtain future financing.

In general, a company should use debt financing for capital items such as plant and equipment, computers, and fixtures that will be used for several years. By incurring debt for such items, especially when interest rates are low, a firm can release operating cash flows for day-to-day operations or new opportunities. For short-term needs, consider establishing a line of credit.

Regardless of the form of financing chosen, all businesses must produce a product or service that others want to buy. Debt should be viewed as a tool – one of many – to help your company thrive.

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FINANCIAL TIPS FOR THE 20-SOMETHING GENERATION

The earlier you start, the easier it will be to get ahead financially. Here are some recommendations for those in their early twenties.

Pay yourself first. Every time you get paid, put something aside in a savings or investment account. As a general rule, save 10% of your income. Even smaller amounts add up over time.

Watch your plastic. Credit cards are an expensive form of debt, and it's easy to lose control of them. Try to pay your entire credit balance every month, even if it's a stretch. If you've been carrying a balance, buy nothing more on credit until the balance is zero.

Keep a clean credit record. If you plan to own a home, buy a car, or start a business, you're going to need squeaky-clean credit. Keep all of your financial obligations current, and never make a financial commitment that you can't keep. If you fall behind on any obligation, talk to the creditor immediately to make alternative arrangements.

Make sure you have adequate medical coverage. You may not see a doctor even once this year. But if you do need medical care, it could be for something serious and expensive. Anything less than a good major medical policy could ruin you financially.

Watch your expenses. At this point in your career, you may not receive large or frequent pay raises, but you can achieve the same effect by cutting expenses. Shop before you buy. Very similar – and sometimes identical products – are sold at widely varying prices. Wise shopping can be the equivalent of having a good-paying second job.

For assistance with financial strategies suitable for your particular age and situation, give us a call.

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