

Client Bulletin

Smart Tax, Business & Planning Ideas *from your Trusted Business Advisor*SM

Deducting Charitable Gifts

March 2016



Charitable donations usually can be deducted on Schedule A of Form 1040, along with other itemized deductions. You should have the required support materials, in case your charitable deduction is questioned.

This article will cover the rules on cash contributions: donations by cash, check, electronic funds transfer, debit or credit card, or payroll deduction. Separate rules apply to noncash donations; contact our office if you have questions about noncash contributions.

To be deductible, your gift must go to a qualified organization. Public charities, nonprofit groups, and educational institutions generally qualify. The IRS provides an app for investigating charitable

organizations at <https://apps.irs.gov/app/eos/>.

You can deduct only the amount that exceeds the fair market value of any benefit you received for your contribution. That's the case if the amount you gave entitled you to merchandise or admission to an event, such as a charity dinner.

Example 1: In 2015, you gave a check for \$200 to a local charity. In exchange, you received two theatre tickets worth \$60 apiece. Your charitable

deduction would be \$80: the difference between your \$200 outlay and the \$120 value of the tickets you received.

Donations under \$250

Assuming you have contributed to an organization that is a qualified recipient, the evidence required will depend on the amount of the deduction you claim. As long as the gift is under \$250, all you'll need is a bank record, such as a monthly bank or credit card statement or a canceled check. If that's not practical, you can support your deduction with a written communication from the donee organization. The letter should contain the name of the organization, the amount of the contribution, and the date you made it.

What's Inside

- 1 Deducting Charitable Gifts
- 3 Tax-Efficient IRA Withdrawals
- 6 Cybersecurity for Business Owners
- 6 Tax Calendar

Puny Payouts

The dividend yield on the S&P 500, which ranged from 3% to 7% from 1950 to 1990, has been below 3% for the past 20 years and stands at about 2%, as of this writing.

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continued on page 2

For payroll contributions, the required record can be a pay stub, a Form W-2, or another document from your employer showing the date and amount you gave. You'll also need a pledge card or another document from or prepared for the donee organization showing the name of the organization.

Donations of \$250 and up

For cash contributions of \$250 or more, a bank record won't be enough to support the deduction. You'll need a written acknowledgment, as mentioned previously, but this document must provide more details. The acknowledgment must be received before you file your tax return or the return's due date (including extensions), whichever comes first. If

the acknowledgment does not show the date of the contribution, you also must have a bank record or receipt that shows the relevant date.

The acknowledgment letter also must say whether the donee organization provided any goods or services in exchange for the gift. If goods or services were provided, the letter must include a description of whatever was provided and a good faith estimate of the value of those goods or services. You can deduct the net amount.

If you made more than one \$250 contribution to a particular organization during the year, you must have a separate acknowledgment for each contribution, or a single acknowledgment that lists each contribution, the date of each

contribution, and the total amount of the contributions.

Calculating the contribution

When you are determining whether your contribution is \$250 or more, don't combine separate contributions.

Example 2: Sarah Wilson gave her church \$20 by check each week last year, for a total of \$1,040 in 2015. When Sarah deducts these contributions, she does not have to combine those payments. Instead, she treats each \$20 payment as a separate contribution, so the rules for contributions of \$250 or more don't apply.

If you make your donations by payroll deduction, the deduction from each paycheck is treated as a separate contribution. ■

Tax-Efficient IRA Withdrawals

Many people save for retirement by putting pretax dollars into an employer-sponsored retirement plan, such as a 401(k). Those dollars may be rolled into an IRA, perhaps at retirement or after a change in jobs. An IRA rollover can maintain the tax deferral.

Ultimately, those pretax dollars will be withdrawn and reported as taxable income. If you are retired then, in a lower tax bracket because you no longer have earned income, the entire process

might have saved you considerable amounts of tax.

That's not necessarily the outcome you'll experience, though. You might find your income is relatively high when you take IRA distributions.

Example 1: Meg Parker saves industriously in her company's 401(k) plan and rolls the balance to an IRA when she retires. Meg continues to leave her IRA untouched, in order to let the account grow for more years, tax-deferred. However, beginning when Meg reaches age 70½, she must take at least required minimum distributions (RMDs) each year, according to an IRS table.

In this hypothetical example, Meg's IRA has grown so large that her RMDs plus her other annual income place her into a higher tax bracket than she had during her working years. Thus, her IRA distributions will be taxed at a higher rate than Meg expected.

Other circumstances also might increase the tax rate on Meg's IRA

withdrawals. Overall tax rates might be higher when she takes money from her IRA. Meg might have moved to a state with a high income tax rate; she might be married to a spouse who reports substantial income on their joint tax return.

For these and other possible reasons, it can make sense to take steps to withdraw money from your IRA and other tax-deferred accounts in a tax-efficient manner.

Avoiding penalties

The best time to take money from your IRA may be when you're between the ages of 59½ and 70½. Once you pass 59½, you can take IRA withdrawals without owing a 10% fine for early distributions. Meanwhile, you don't have to take RMDs until you reach 70½. In the interim, you can take as little or as much from your IRA without owing any penalties.

One possible tactic is to make the most of relatively low tax brackets, in a calendar year.

Did You Know?

Spending on prescription drugs in the United States grew by 12.2% in 2014, the last year on record, compared to 2.4% growth in 2013. The 2014 increase was fueled largely by spending for new medicines, particularly for specialty drugs such as those used to treat hepatitis C.

Source: cms.gov

Example 2: Paul King is 62 years old in 2016. He files a joint tax return with his wife Lynn, who is 57. The Kings reported \$125,000 of taxable income on their 2015 tax return, and they expect their taxable income to be about the same in 2016. If so, the Kings will be in the 25% federal income tax bracket this year, which ranges from \$75,300 to \$151,900 of taxable income.

In this example, Paul could take \$25,000 from his IRA, bringing the couple's taxable income for the year to \$150,000. Therefore, the Kings would remain in the 25% tax bracket for the year, and they would owe only \$6,250 (25% of \$25,000) on his IRA withdrawal.

The Kings could spend those dollars, or Paul could move the money into a Roth IRA. Because Paul already is older than age 59½, after five years he would be able to take as much as he wants from the Roth IRA, tax-free.

Such a strategy can be implemented every year, to provide the Kings with extra cash flow in retirement or to accumulate funds within a Roth IRA. Moreover, drawing down a traditional

IRA during those years will enable Paul to reduce the size of his account and decrease his future taxable RMDs.

Note that taking \$25,000 from his traditional IRA will increase Paul's adjusted gross income (AGI) as well as his taxable income. A higher AGI, in turn, could add to the Kings' tax bill in other areas—they might lose medical deductions, for instance. Our office can review any IRA withdrawals you plan for overall tax efficiency.

Earlier distributions

In example 2, the money came out of Paul's IRA rather than Lynn's IRA. At age 57, Lynn would trigger a 10% penalty by taking money from her IRA, negating the benefit of the relatively low tax bracket. However, there are many exceptions to the 10% early withdrawal penalty. If you can qualify for one of them, you might be able to take IRA withdrawals at a modest tax rate, at any age.

One such exception covers withdrawals for higher education expenses.

Example 3: Gregg and Lois Carter are both age 48; in 2016 their

taxable income, after deductions, is expected to be around \$60,000. This year, the Carters estimate that they'll spend \$15,000 on their daughter's college costs.

In 2016, the 15% tax bracket includes up to \$75,300 of taxable income. Thus, Gregg and Lois could take \$15,000 from their traditional IRAs and remain in the 15% tax bracket. They would not owe a 10% early withdrawal penalty because that \$15,000 withdrawal does not exceed their qualified higher education costs.

Other exceptions to the 10% penalty for IRAs include those for the account owner's death or disability, qualified first-time home purchases (up to \$10,000), certain medical insurance premiums paid while unemployed, unreimbursed medical expenses that exceed a certain percentage of your adjusted gross income, payments due to an IRS levy and qualified reservist distributions. In addition, you can avoid the penalty by taking substantially equal periodic payments for your life (or life expectancy) or the joint lives (or joint life expectancies) of yourself and a designated beneficiary. ■

Cybersecurity for Business Owners

Data breaches at large companies often make headlines. The good news is that major corporations have the resources (and, increasingly, the motivation) to protect themselves from electronic intruders. If your company does business with firms in the S&P 500, your personal and business data probably are secure.

The bad news? Thwarted hackers and identity thieves may step up attacks on small and medium-sized companies. Such firms often do not have strong defenses in place, so they may be vulnerable.

Consequently, your company's customer data and banking information may be targets. Dealing with electronic theft can be costly and time consuming—and extremely stressful. If you suffer a data breach and word gets out, damage to your reputation can be severe. Small companies may even be forced out of business as a result.

Putting protection in place

To avoid such disasters, you need to recognize the risk and adopt a plan to secure your electronic information. It may be well worth the time and

money to bring in a third party expert to review your cybersecurity and make recommendations.

Often, recommendations include a program of educating your employees about data security, with periodic sessions to inform your staff about new threats. For example, if employees need passwords to access private information, they should avoid using the same password for years, on multiple websites.

You might want to investigate using a password manager yourself, for company-related matters, and having employees use one as well.

continued on page 4

Password managers, found online, store someone's login information for various websites and allow users automatic entry. The user has just one master password to remember while different, changing passwords are submitted to provide the desired access.

There are also services that can securely transfer sensitive files, if you prefer not to send them as an email attachment.

Protection points

In addition, your company should take steps to protect against malware: hostile or invasive software that may be used to steal personal information and commit fraud. You can reduce

your risk in this area by installing antivirus software and keeping it current. Your company also can implement policies regarding the types of websites and data that employees may access while on a company network.

The U.S. Chamber of Commerce offers suggestions for establishing policies for employees' acceptable use of electronic devices. Employers might require the following:

- Logging off or applying a screen lock to their computer before leaving it unattended even for a short break.
- Assigning employee responsibility for computer access and equipment taken off-site.



- Limiting employee and family members' personal use of company computers.
- Limiting the use of personal machines on the company network.
- Establishing employee liability when personal acceptable use has not been followed. ■

TAX CALENDAR

MARCH 2016

March 15

Corporations. File a 2015 calendar year income tax return (Form 1120) and pay any tax due. If you want an automatic six-month extension of time to file the return, file Form 7004 and deposit what you estimate you owe.

S corporations. File a 2015 calendar year income tax return (Form 1120S) and pay any tax due. Provide each shareholder with a copy of Schedule K-1 (Form 1120S), Shareholder's Share of Income, Deductions, Credits, etc., or a substitute Schedule K-1. If you want an automatic six-month extension of time to file the return, file Form 7004 and deposit what you estimate you owe.

S corporation election. File Form 2553, Election by a Small Business Corporation, to choose to be treated as an S corporation beginning with calendar year 2016. If Form 2553 is filed late, S corporation treatment will begin with calendar year 2017.

Electing large partnerships. Provide each partner with a copy of Schedule K-1 (Form 1065-B), Partner's Share of Income (Loss) From an Electing Large Partnership, or a substitute Schedule K-1. This due date applies even if the partnership requests an extension of time to file the Form 1065-B by filing Form 7004.

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in February if the monthly rule applies.

APRIL 2016

April 18

Individuals. File a 2015 income tax return. If you want an automatic six-month extension of time to file the return, file Form 4868,

Application for Automatic Extension of Time To File U.S. Individual Income Tax Return. Then, file Form 1040, 1040A, or 1040EZ by October 17.

If you are not paying your 2015 income tax through withholding (or will not pay in enough tax during the year that way), pay the first installment of your 2016 estimated tax. Use Form 1040-ES.

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in March if the monthly rule applies.

Household employers. If you paid cash wages of \$1,900 or more in 2015 to a household employee, file Schedule H (Form 1040) with your income tax return and report any household employment taxes. Report any federal unemployment (FUTA) tax on Schedule H if you paid total cash wages of \$1,000 or more in any calendar quarter of 2014 or 2015 to household employees. Also report any income tax you withheld for your household employees.

Partnerships. File a 2015 calendar year return (Form 1065). Provide each partner with a copy of Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc., or a substitute Schedule K-1. If you want an automatic five-month extension of time to file the return and provide Schedule K-1 or a substitute Schedule K-1, file Form 7004. Then file Form 1065 by September 15.

Electing large partnerships. File a 2015 calendar year return (Form 1065-B). If you want an automatic six-month extension of time to file the return, file Form 7004. Then file Form 1065-B by October 17.

Corporations. Deposit the first installment of estimated income tax for 2016.