

Leasing property to a closely held corporation

Shareholders of closely held C corporations routinely lease real estate, equipment, and other property to their corporate entity. These leases can be held directly by the shareholder or through a separate entity, such as a partnership, LLC, or S corporation.

Of course, the corporation could directly purchase the item or lease it from an independent source. However, advantages that can motivate these leasing arrangements include the following:

- a. Avoiding payroll taxes. Rental income from real estate is not subject to self-employment (SE) tax. A lease of real estate to a closely held corporation represents the ability to withdraw funds from the corporation without incurring Social Security or Medicare (FICA) taxes.
- b. Avoiding corporate-level gain. Retaining ownership of real estate and other valuable tangible or intangible assets outside the corporation avoids the potential for triggering a gain within the corporation at either distribution or liquidation of the assets. If appreciated assets (those with an FMV in excess of adjusted tax basis) are distributed from a corporation, whether in liquidation or other form of distribution, gain must be recognized.



- c. Retirement cash flow. Retaining valuable assets outside a controlled corporation allows the shareholder-lessor to continue to receive a cash flow stream in the form of rent or royalties, even though the shareholder is no longer actively employed by the corporation. This can allow a portion of the corporation income to flow to a retired shareholder or a shareholder who is uninvolved in the business operations.
- d. Business transition. Retaining assets outside the corporation provides a natural segregation between the ownership of the business and the ownership of business assets. For example, a controlling shareholder-lessor may want to divest ownership and control of the business operations by disposing of some or all of the corporate stock, but retain a portion of the business assets for lease to the entity. This can help transfer ownership and control to a successor by minimizing the value of the corporation (e.g., when the corporation contains only operating assets, such as receivables and inventory, with fixed assets retained by the founder).

In this issue.....

- Leasing property to a closely held corporation
- Taxing a child's investment income
- Don't be a charity scam victim
- Taxable tip income
- Avoiding penalties on IRA withdrawals before age 59.5
- Taxing Social Security benefits

As you plan your business operations, keep these potential advantages in mind. It is also important to understand that, as with most areas of tax law, some restrictions and limitations apply to shareholder-to-corporation leasing transactions. Therefore, please contact us to discuss the details of how these arrangements should be structured before you sign the lease.

Taxing a child's investment income

Some children who receive investment income are required to file a tax return and pay tax on at least a portion of that income (and possibly at the parents' marginal tax rate). This is often referred to as the kiddie tax. The kiddie tax cannot be computed accurately until the parents' income is known. Thus, the child's return may have to be extended until the parents' return has been completed. Additionally, if the parents' return is amended or adjusted upon IRS audit, the child's return could require correction (assuming the changes to the parental return affect the tax bracket). If a child cannot file his or her own tax return for any reason, such as age, the child's parent or guardian is responsible for filing a return on the child's behalf.

There are tax rules that affect how parents report a child's investment income. Investment income normally includes interest, dividends, capital gains, and other unearned income, such as from a trust. Some parents can include their child's investment income on their tax return. Other children may have to file their own tax return. Special rules apply if a child's total investment income is more than \$2,000. Finally, the parents' tax rate may apply to part of that income instead of the child's tax rate.

Note: Higher income individuals subject to the 3.8% net investment income tax (3.8% NIIT) may benefit from shifting income to and having their child claim investment income on the child's tax return. This may be advantageous because the child receives his or her own \$200,000 exclusion from the 3.8% NIIT.

Don't be a charity scam victim

When a natural disaster strikes, thieves often play on the goodwill of people by posing as representatives of real charities to steal money or get information to commit identity theft.

Bogus charities use several different tactics to get money and information from unsuspecting individuals. They may claim to be with, and use the names similar to, legitimate charities. They often use e-mail to steer people to bogus websites that look like real charity websites. Scam artists will contact people by phone or e-mail to get their victims to donate money or give them financial information. To avoid being scammed, don't give your Social

Security number, credit card information, bank account numbers, or passwords to anyone.

Only donations to qualified organizations are tax-deductible. For legitimate charitable contributions, contribute by check or credit card to provide documentation for tax purposes — never donate cash. Finally, if you suspect fraud, report it to the appropriate authorities.

The "Dirty Dozen," compiled by the IRS each year, lists common scams that taxpayers encounter. Unsurprisingly, tax fraud using identity theft tops the list this year. Next on the list is telephone scams, with callers pretending to be from the IRS in an effort to steal money or identities from their victims. You can find the complete 2014 Dirty Dozen listing by going to www.irs.gov and entering "dirty dozen" in the search box.

Taxable tip income

If you receive tips on the job from customers, you must include those tips in the computation of your tax liability, if any. This includes tips directly from customers, tips added to credit cards, and your share of tips received under a tip-splitting agreement with other employees. The method for paying out charge tips is determined by the employer. Charge tips can be distributed daily or accumulated and paid through regular payroll. The value of noncash tips, such as tickets, passes, or other items of value, is also subject to income tax.

If you receive \$20 or more in tips in any one month, from any one job, you must report your tips for that month to your employer. The report should only include cash, check, and debit and credit card tips you receive. Your employer is required to withhold federal income, Social Security, and Medicare taxes on the reported tips. You are not required to report the value of any noncash tips to your employer, but they are taxable.

Avoiding penalties on IRA withdrawals before age 59 1/2

IRA owners can withdraw money from their account at any time and for any reason because the owner is in total control of this account. Most withdrawals from traditional IRAs will be at least partially taxable.

To add insult to injury, the taxable portion of a withdrawal made before age 59½, referred to as an "early withdrawal," will be subject to a 10% penalty tax. (This penalty can be as high as 25% on early withdrawals from a SIMPLE IRA.) Finally, there can even be a 10% penalty tax assessed on a nontaxable portion of some early withdrawals from Roth IRAs.

The 10% penalty tax was implemented to encourage long-term saving for retirement, which is clearly a sound financial objective. But, sometimes financial circumstances make it necessary to withdraw retirement-oriented savings before age 59½. If you must make an early withdrawal, there are some ways to avoid the penalty tax. Early withdrawals from IRAs, including traditional IRAs, SEP accounts, SIMPLE IRAs, and Roth IRAs, can be exempt from the premature withdrawal penalty tax in the following cases:

- Withdrawals that count as substantially equal periodic payments (SEPPs) using an IRS-approved method.
- Withdrawals for medical expenses in excess of specific AGI levels.
- Withdrawals by military reservists called to active duty.
- Withdrawals for IRS levies.
- Withdrawals paid to a deceased plan participant's estate or beneficiary after death.
- Withdrawals after becoming physically or mentally disabled.
- Withdrawals for first-time home purchases (\$10,000 lifetime limit).
- Withdrawals for qualified higher education expenses.
- Withdrawals to pay health insurance premiums during unemployment.

Unlike early withdrawals from a qualified plan (e.g., 401(k)), the penalty exception allowing early withdrawals paid to the plan participant's spouse or ex-spouse or dependent under a Qualified Domestic Relations Order (QDRO) pursuant to divorce proceedings is not available for early IRA distributions.

Caution: If a taxpayer chooses to take SEPPs, these payments must be calculated correctly using an IRS-approved method and taken for the requisite number of years. Otherwise, all pre-age-59½ withdrawals will be hit with the 10% penalty tax!

In a time of economic need, an IRA can be a source of liquidity even before age 59½. If the need is short-term, an IRA withdrawal and redeposit of the same amount within 60 days can be tax-free. If the need is long-term and before age 59½, the withdrawal may be fully or partially taxable, but one of the previously listed exceptions may be used to avoid the 10% early withdrawal penalty.

Please contact us to discuss IRA withdrawals before age 59½ or any other tax compliance or planning issue.

Taxing Social Security benefits

Some taxpayers must include up to 85% of their Social Security benefits in taxable income, while others find that their benefits are not taxable at all. If Social Security is your only source of income, your benefits probably won't be taxable. In fact, you may not even need to file a federal income tax return. If you get income from other sources, however, you may have to pay taxes on at least a portion of your Social Security benefits. Your income and filing status will also affect whether you must pay taxes on your Social Security benefits.

A quick way to find out if any of your benefits may be taxable is to add half of your Social Security benefits to all your other income, including any tax-exempt interest. Next, compare this total to the following base amounts. If your total is more than the base amount for your filing status, then some of your benefits may be taxable. The three base amounts are:

- \$25,000 for single, head of household, qualifying widow or widower with a dependent child, or married individuals filing separately and who did not live with their spouse at any time during the year.
- \$32,000 for married couples filing jointly.
- \$0 for married persons filing separately who lived together at any time during the year.

To avoid tax time surprises, Social Security recipients can request that federal income tax be

withheld from their benefit payments. Withholding is voluntary and can be initiated by completing IRS Form W-4V ("Voluntary Withholding Request"), requesting to have 7%, 10%, 15%, or 25% (those are the only choices) withheld for federal income tax, and submitting the form to the local Social Security Administration office. Voluntary withholding can be stopped by completing a new Form W-4V.

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Don't hesitate to reach out to discuss your wealth management needs. Call us today for an appointment.

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