BUILDING WEALTH IN CHANGING TIMES

The Solari Report

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US Tax Issues for 2013-14

with Patty Kemmerer

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C. AUSTIN FITTS: Well, ladies and gentlemen, this is a real privilege. I'm inviting, as I described in my blog post, somebody to The Solari Report who I believe fits the description of a great accountant. As you know, it's hard to find, and if you do, treasure them forever. Patty Kemmerer is a member of Kemmerer Schooley Smith CPAs in northern Virginia. She has a wealth of experience working with businesses, individuals, and not-for-profits. I first met her when I was at Hamilton Securities, so I can tell you she also has a lot of experience dealing with all the complexities of government and government contractors and the issues that they deal with. She's a member of many accounting societies, but one of the things I most appreciate about Patty is she's very experienced, very grounded, very practical and yet can deal with all the complexities that is involved when you deal with all these different kinds of issues. So I asked Patty to join us to discuss, for those who file U.S. taxes, both individual and small business issues that are the most important to focus on in 2013. We're coming into 2014, so what are the actions we can take before the end of the year or need to take at the beginning of the year to make sure we're on top of our taxes. So, Patty, it's the holiday season. Thank you for taking time out of what I know is a very busy schedule to join us on The Solari Report.

PATTY KEMMERER: Well, thank you very much for having me. I really appreciate it.

C. AUSTIN FITTS: Okay, well, top of our list, of course, is the Affordable Health Care Act, which I must tell you, we had a rule in Washington, which was never do something too complicated that the average person is going to have to deal with. Of course, every time I try and understand Affordable Health Care Act, I think, "uh oh, they broke the rule." So take us through the Affordable Health Care Act. We're now in a period when it applies, so what does it mean to our taxes? What do we need to

know about the Affordable Health Care Act?

PATTY KEMMERER: Well, as you know, all individuals that are required to have that minimum essential coverage by March 31, 2014, or they have to be exempt in order to avoid the shared responsibility payment, which is being commonly addressed as the penalty for not having the coverage by March 14th. The shared responsibility payment and the Act itself is effective January 1, 2014. It applies to all individuals of all ages, including children. So adults, or a married couple who claim an individual as a dependent, is responsible to make the payment for the dependent that doesn't have coverage. So parents need to be aware of that. It's not just them; it's also their children that have to be covered or they have to pay the shared responsibility payment penalty with their tax return when they file their 2014 taxes in 2015.

There are some exemptions for people to be excluded from this, and just to go over a few of the more common ones, if a person does not have a filing requirement, they are not required to pay the shared responsibility payment. That would be someone whose income is below the minimum threshold for filing a tax return. So if you don't have to file a tax return because you're below that threshold, you're not required to pay the shared responsibility payment if you don't have coverage. Also, if you have a short coverage gap (being without coverage for less than three consecutive months during the year), then you also don't have to pay the penalty. If there's a hardship, the health insurance marketplace has determined conclusively that a person has a hardship that makes them unable to obtain coverage; they're also excluded from paying the penalty. In addition, if a person is now lawfully present in the United States, they're also exempt from paying the penalty.

C. AUSTIN FITTS: Is lawfully present – do you know what the time period is on that?

PATTY KEMMERER: I do not know what the time period is. I presume that it's during the calendar year, or at the calendar year. If you're not lawfully present, you're still required to file tax returns in theory, but because you would probably meet the substantial presence test. That is if

you're in the country, even illegally, for more than 183 days of the year and you earn money here, you're supposed to file a tax return, but if you're here unlawfully, you're not required to pay this penalty if you don't have health insurance coverage by the deadline. Also, just to let people know, the shared responsibility payment penalty is the greater of 1 percent of yearly household income or $95 per person, $47.50 for a child under 18 for 2014. The maximum household penalty for 2014 is $285. So you hear many people talking about, well, they'll just pay the penalty. It's a fairly low penalty in 2014, but it will go up to 2 percent of income and $325 per person in 2015, and 2.5 percent of income or $695 per person for 2016. After that it'll be adjusted for inflation. So while it's fairly low penalty in 2014, as you can see, it will go up and will become more substantial as time goes on.

"The maximum household penalty for 2014 is $285. So you hear many people talking about, well, they'll just pay the penalty."

C. Austin Fitts: Right. It's interesting because I know people who live with family and so the household income is defined in a way that catches a lot of income, which is not available to them, and I've literally had people tell me they're thinking of getting divorced just because they can't afford to pay the penalty.

Patty Kemmerer: I've heard that as well, but household income is household income, so getting divorced, if you're still going to live together, I'm not sure that that will avoid the issue. So that would be very sad.

C. Austin Fitts: Penalties are sad. Okay, so now the White House has delayed the application to small business, or to business, for a year. Is that correct?

Patty Kemmerer: That is correct. That just recently came about.

C. Austin Fitts: The debate when there was the squabble at the beginning or recently was over whether or not they would delay individuals, and

they haven't. This still applies.

PATTY KEMMERER: This does still apply. This has not been delayed for individuals.

C. AUSTIN FITTS: Okay. So let's keep going on the health care issues.

PATTY KEMMERER: Okay. Also, there is a premium tax credit that is available for lower-income individuals that can assist with lowering the premiums. They have to buy the health insurance through the marketplace. They have to be ineligible for coverage through an employer or a government plan. They have to be within these lower income limits. If they're married, they have to file a joint return and they cannot be a dependent of another person. So if a person is eligible for this premium tax credit, they have two choices of what to do with it. They can take it, sort of an advance on it, now and have the credit paid directly to the insurance company to lower their out-of-pocket cost on a monthly basis, or can get it later when they file their tax return. So those are two choices for the premium credit.

Also, as you know, there were some surprises in this law related to an additional Medicare tax of 0.9 percent for taxpayers who have earnings over applicable thresholds in 2014, and that would be –

C. AUSTIN FITTS: That's $200,000 on earned income or it includes investment income?

PATTY KEMMERER: Well, it's on earnings of $200,000 or more for a single filer or $250,000 for married filing joint, and that is joint income. So a married couple is much more likely to reach the threshold faster than, perhaps, a single individual would be. Now once a person reaches $200,000 in earned income, their employer is supposed to withhold the additional 0.9 percent of tax that they're required to pay, and this is only a tax on the employee. The employer does not have to match that 0.9 percent for those wages above $200,000 like they do for the other wages that they pay the 2.9 percent Medicare tax. It's 1.45 percent for the individual earner and 1.45 percent for the employer. The employer

continues just to pay the 1.45 percent there. They don't have to pay the additional 0.9. If the employer doesn't withhold it, ultimately the employee is going to be liable to pay it with their tax return, and in theory, the employer could be fined for not withholding it when they're supposed to.

C. AUSTIN FITTS: Now, the investment tax is on top of this one.

PATTY KEMMERER: Right. It's 3.8 percent. It applies to taxpayers who have earnings above those same thresholds - $200,000 for a single filer and $250,000 for married filing joint return.

C. AUSTIN FITTS: Okay, so let's say I have $200,000 of earned income. I have $100,000 of capital gains and $100,000 of dividend and interest income in a given year. The 3.8 is on the dividend and interest. It's going to be across the board since I already have $200,000 of earned income.

PATTY KEMMERER: Correct.

C. AUSTIN FITTS: Is it going to be 3.8 on capital gains as well?

PATTY KEMMERER: It will. It's going to be on income from interest, dividends, annuities, royalties and rents. So people with rent –

C. AUSTIN FITTS: On rent as well?

PATTY KEMMERER: Yes, on rent as well. It's also going to be on income that passes through from a trade or business if the person is passive in that business. That is to say that they're simply an investor in a small business or in a REIT or whatever they're invested in, and not an active participant in the day-to-day activities. They're considered to be a passive investor. It's an investment for them, not a business, and so those funds coming through from K-1s, from partnerships and S-Corporations, would also be hit with this 3.8 percent.

C. AUSTIN FITTS: So if you're over $200,000, basically your capital gains rates changed to 18.8 percent.

PATTY KEMMERER: Well, yes, that's correct. It actually could be higher than that if you're up in the 20 percent capital gains rate, and then you add this on top of it so it becomes 23.8 percent.

Also, one thing that a lot of people probably are not aware of is if someone is selling their principal residence and they have more than $250,000 in gain if they're single or $500,000 in gain if they're married filing joint, the amount above those two thresholds is taxable for capital gains tax and will be subject to this 3.8 percent if they're over the earned income thresholds.

C. AUSTIN FITTS: Even if it's their primary residence.

PATTY KEMMERER: Even if it's their primary residence.

C. AUSTIN FITTS: Wow. So that's a very significant hit.

PATTY KEMMERER: Yes, it could be.

C. AUSTIN FITTS: Yes, it could be. Okay.

PATTY KEMMERER: Now, the type of income that is excluded from the 3.8 percent net investment income tax are things like nontaxable and municipal bond interest, for example, would not be included for this. Social Security benefits and alimony are excluded. Retirement plan distributions are excluded and any income that's subject to self-employment Medicare tax would be excluded; for example, a self-employed person with a Schedule C.

C. AUSTIN FITTS: Okay. Well, let's turn to what I call health savings accounts. Let's walk through sort of what the new limit is, but also I'd be very interested to hear if you think what's happening is going to increase interest in health savings accounts.

PATTY KEMMERER: Right. There is a new limit on the health savings account of $2,500 is the most that an employee can request for a salary reduction as a contribution to the flexible spending arrangement or are we talking about health savings – the HSA?

C. Austin Fitts: Right.

Patty Kemmerer: Okay, so the HSA.

C. Austin Fitts: Is health flexible spending arrangements the same thing as an HSA?

Patty Kemmerer: It is not.

C. Austin Fitts: It's not. Okay.

Patty Kemmerer: The flexible spending arrangement is a deduction from taxable income right off the top. They can have their employer withhold certain amounts that can then be spent later for health purposes, for medical reasons, daycare and the like. So that's a flexible spending arrangement, it's also called a Section 125 plan where people can put the money aside for use later. The limit on that is now $2,500 that can be requested to be set aside from a paycheck to pay for future medical expenses.

"The flexible spending arrangement is a deduction from taxable income right off the top. They can have their employer withhold certain amounts that can then be spent later for health purposes, for medical reasons, daycare and the like."

C. Austin Fitts: Can't that be used to pay for your health care plan or insurance?

Patty Kemmerer: It can.

C. Austin Fitts: It can, right.

Patty Kemmerer: It can, yes. But you wanted to talk HSAs?

C. Austin Fitts: If you're ready to. Solari keeps playing with starting an HSA, so –

Patty Kemmerer: Yes. For an HSA, you can deduct the contributions that you make through the account and the earnings on those are tax-deferred until they're withdrawn, much like an IRA.

C. AUSTIN FITTS: Right.

PATTY KEMMERER: If they're withdrawn for medical purposes, they are withdrawn tax-free.

C. AUSTIN FITTS: So if the employee takes the money out of the HSA to use it to buy health care insurance, at that point it's not taxable to the employee, so it's tax-free?

PATTY KEMMERER: Well, you have to have a high-deductible health plan in place for the HSA – to have an HSA. You can't be enrolled in Medicare. So in 2013 and 2014, the minimum deductible for a high-deductible health plan has to be at least $1,250 for single coverage and $2,500 for a family coverage.

C. AUSTIN FITTS: Okay.

PATTY KEMMERER: Now, if funds are not used for medical purposes, once you turn 65, you can withdraw the money out to use for any purpose and it's taxed just like an IRA.

C. AUSTIN FITTS: Okay. But there's no penalty for withdrawal.

PATTY KEMMERER: Right. After age 65.

C. AUSTIN FITTS: Okay. So tell us, what are the steps now. We're going to play this on December 5th. What can we do now before the end of the year to ease our tax burden for '13 and '14?

PATTY KEMMERER: Well, before we jump there, let me just back up one second if you don't mind and just mention that the Schedule A deduction, or the Schedule A medical deduction now has to exceed 10 percent of your adjusted gross income. It has been 7.5 percent. This is part of the Affordable Care Act as well. So that threshold has now increased to 10 percent, so your medical expenses have to exceed 10 percent of your adjusted gross income in order for you to take any deduction for medical expenses. For people who are 65 and older, the

7.5 percent remains in place through 2016, but if you're under 65, it's jumped – actually for 2013 has jumped to 10 percent. Just so people are aware of that as well.

Now, back to your question, which was what can we do at this point in time. If someone thinks if they're not at that $200,000, $250,000 threshold yet in 2013 to trigger this 0.9 percent and the 3.8 percent additional taxes, but they feel like maybe in 2014 they might push over those limits, one thing that they might be able to do is pull some of those earnings for 2014, if possible, in 2013 to try to avoid triggering those two additional taxes.

C. AUSTIN FITTS: So, for example, if you have gains, you can take them.

PATTY KEMMERER: Exactly. If you have gains, you can take them. If you think it's going to push you over for 2014 but you can take some of them in 2013 and still not push over the limit, and perhaps stay under the limit for 2014 as well, that's one thing that would be a good idea to take a look at.

C. AUSTIN FITTS: Okay.

PATTY KEMMERER: Also, there are things that you can do to accelerate deductions into 2013 if you feel like you're getting close to that limit in 2013 and you want to reduce your income. You can pay your fourth quarter state estimated tax installments in December instead of January because you can get the deduction for them in 2013 if you just pay them a couple weeks early in December. You could pay your entire property tax bill, including installments due in 2014 by the end of the year and also pull that into your deductions for 2013. You can try to bunch your threshold expenses. When I say threshold expenses, I mean things like medical expenses that have to exceed that 10 percent threshold, an there's also miscellaneous itemized deductions that have to exceed 2 percent of your adjusted gross income before you can take any deduction. Those would be things like investment expenses, job hunting expense, and home office deductions for persons who are employees of a company but who work at home for the convenience of their employer.

Anything that you can pull into 2013 could help reduce the 2013 income. Also, you could pay 2014 tuition if you have a college student. You pay the 2014 tuition in 2013 and perhaps get a deduction or credit for that.

In addition, there are some non-business energy credits that you might be able to take for 2013. The credit is 10 percent of the cost of certain energy-saving property that you add to your main home. It includes qualified insulation, windows, doors, roofs and biomass stoves. It has to be on your existing main home in the United States. A newly constructed home or a rental does not qualify for these credits. There's a maximum lifetime limit of $500 on the credits, and when I say it's a credit, I mean it's a dollar-for-dollar credit. That means for each dollar of credit, you reduce $1.00 of tax liability for these particular credits.

C. Austin Fitts: So if I spend $500 on tighter doors, that'd qualify?

Patty Kemmerer: Yes, you would get 10 percent. You get 10 percent, yes.

C. Austin Fitts: So I'd get $50.

Patty Kemmerer: Right. That would be a $50 reduction in your tax bill.

C. Austin Fitts: Now, those are extended through 2013. Will they apply in 2014?

Patty Kemmerer: I believe that one is going away, actually, for 2014.

C. Austin Fitts: So it's use it or lose it.

Patty Kemmerer: Kind of, yes. You can't just contract for these items. If you're going to get new windows installed, for example, the windows have to be installed by December 31st.

C. Austin Fitts: Okay. So the home improvement guys are going to be very busy before the end of the year.

Patty Kemmerer: Yes, I think so. So you know, if you want to get new windows, probably now is the time to call. By the way, speaking of windows, only $200 of the $500 can go towards windows. That's the maximum for window credit.

C. Austin Fitts: If you look at how expensive windows are, I'm not sure it's going to go far, but –

Patty Kemmerer: I agree, but you know, every little bit helps.

C. Austin Fitts: Every little bit counts, yes.

Patty Kemmerer: Exactly.

C. Austin Fitts: Okay, so let's talk about gifting.

Patty Kemmerer: Well, one of the things you can do is do some charitable gifting. You know, there's been a law over the last few years, which also is going to expire at the end of this year where you can transfer directly up to $100,000 from your IRA to a charitable organization and get a deduction for it. That is expiring at the end of this year. That has been in place for several years, but this is the last year to do that. Also, for those of us –

"There's been a law over the last few years, which also is going to expire at the end of this year where you can transfer directly up to $100,000 from your IRA to a charitable organization and get a deduction for it."

C. Austin Fitts: So someone could, for example, if they wanted to donate to their church, they could shift $10,000 out of an IRA to the church and then take a $10,000 deduction on their taxes.

Patty Kemmerer: Schedule A, right. They do have to claim the $10,000 distribution as well, so it's kind of a wash, but at least you don't have to pay the tax on the distribution.

C. Austin Fitts: Okay, so basically what it does is the deduction offsets the tax you'd have to pay on the distribution.

PATTY KEMMERER: That's correct. Now, you can donate cash as well as property to a qualified charity, and generally, when you donate property, you can claim the fair market value of that property as a deduction. Contributions of appreciated property, like stock, for example, provide an additional benefit in that if you donate appreciated stock to a charity, you can write off the value of that stock and avoid paying capital gains tax. So that's an added benefit of donating appreciated investment property. You can also donate services to charity, of course, but the value of your service to the charity is not deductible. Only your out-of-pocket expenses are. I've seen this quite a bit over my more than 25 years of experience in this area. Small businesspeople donate services, graphic design, whatever they're doing, to a charity and they want to write off the value of that, what they would have charged a customer to perform those services, and unfortunately, you're not allowed to do that. Only your out-of-pocket costs are deductible. That would include some charity-related travel expenses and some other out-of-pocket expenses. You must have a written record to take a deduction. If it's under $250, you don't absolutely have to have a receipt from the charity if you can show some other way that you made the donation, for example, a canceled check.

C. AUSTIN FITTS: If we send a donation of $250 to a 501(c)3, do we need to get a letter back saying that we've made this donation and it does not include payment for goods or services?

PATTY KEMMERER: Yes.

C. AUSTIN FITTS: So we need a letter. Okay.

PATTY KEMMERER: Yes, some kind of receipt, a letter.

C. AUSTIN FITTS: Okay. So keep going.

PATTY KEMMERER: Okay. So that's a current deduction on your current year taxes for charitable donations. Now, another thing we probably need to touch on, which is not a current year deduction, but something people do need to think about is year-end giving to reduce potential estate tax in

the future. Federal gift and estate tax exemptions are currently set at $5.25 million. So that means the first $5.25 million of value of a person's estate is exempt from tax under current law. That's going to increase to $5.34 million in 2014. Also, the maximum estate tax is now capped at 40 percent. People can give gifts to other people of up to $14,000 per year without having to file a gift tax return. Most people don't realize also that the gift tax return is filed by the person who gives the gift, not the person who receives the gift. So that's something to keep in mind. A couple can give a joint gift to a third person of up to $28,000 – that would be $14,000 coming from each of them to the third person. They do, of course, have to agree to gift in order to take the exemption of up to $28,000 for a gift to a third person. That is one way people gift, especially around holiday time, gift to their relatives and friends to be generous, of course, to these folks, but also to try to reduce the value of their estate for future estate tax planning purposes. The gift tax return is due – if you do give a gift that exceeds the $14,000, you do have to file a gift tax return and it's due on the same date as your regular tax return.

C. Austin Fitts: Okay, retirement plan contributions. This one is a big one for our subscribers because I think there's a tremendous amount of concern that the provisions will change over time, so there's always interest. For example, should I move to a Roth? So tell us about retirement plan contributions for 2013.

Patty Kemmerer: Right. If you own a business, you should consider setting up a retirement plan if you don't already have one. You can set up the plan by the end of the year, or even a SEP plan – a Simplified Employee Pension plan – even early next year, make the contribution by the due date of your tax return, including extensions. So potentially, you could push it all the way to October 15th of 2014 and get the deduction on your 2013 tax return. So that's a really good way to help reduce your tax liability and set some money aside for yourself for the future. If you don't plan for your retirement, nobody else will.

C. Austin Fitts: Right. Now, Roth conversions: it's still possible to convert from a SIMPLE IRA to a Roth?

PATTY KEMMERER: It is. You do have to pay the tax on it at the time of conversion, but then that money is considered after-tax dollars in the Roth, so when you draw it out later, you won't pay tax on it later.

C. AUSTIN FITTS: Right. So your fear is if your taxes are going to increase, if the rates are going to increase in the future, that's the benefit of accelerating the tax into this year.

PATTY KEMMERER: Exactly. So if you are an employee and your employer has a 401(k) plan, if at all possible, you should try to maximize your contributions to that for 2013. Time's running out, so you would have to put in a big chunk at this point, perhaps, to get to the maximum contribution, which is $17,500 for a person under the age of 50, and if you're over 50, you could add a $5,500 catch-up contribution as well. If you're an employee, and your employer doesn't offer a retirement plan, you can make a deductible contribution of up to $5,500 to a traditional IRA and deduct it if you are under 50 and an additional $1,000, or $6,500 total, if you're 50 or over.

C. AUSTIN FITTS: Okay, and more on the HSA? Did we want to mention that?

PATTY KEMMERER: Yes, I mean, I think we've pretty much covered that earlier, but you can deduct those contributions to the account, so if you need some more deductions this year, you may want to consider an HSA. You do have to make the contribution to it this year and you have to have that high-deductible health plan in place.

C. AUSTIN FITTS: Now, can an individual start an HSA or do you need an employer?

PATTY KEMMERER: You do not need an employer. An individual can set it up.

C. AUSTIN FITTS: An individual can do it. Okay. Okay, Section 179.

PATTY KEMMERER: Section 179, in 2013, a business can elect to expense the

entire cost of most new equipment up to $500,000 for the first $2 million of property placed in service by December 31. So it's much like the windows and doors. It has to be in place by December 31st.

C. Austin Fitts: And does this apply for all computer and office equipment?

Patty Kemmerer: It sure does.

C. Austin Fitts: Wow. You can write off 100 percent.

Patty Kemmerer: A hundred percent of it up to $500,000.

C. Austin Fitts: Okay.

"In 2014, that deduction limit is reduced from $500,000 down to $25,000 on the first $200,000 of equipment purchased."

Patty Kemmerer: Now, that provision was expanded after 9/11 to try to stimulate the economy. The expanded provision is expiring at the end of this year. In 2014, that deduction limit is reduced from $500,000 down to $25,000 on the first $200,000 of equipment purchased. So you can see there's a precipitous drop after 2013. So if any of your listeners were considering investing in large equipment, they may want to pull that into 2013 and go ahead and buy it now rather than waiting until January or February to do it.

Now it has to be qualified property, and qualified property is placed in service during the tax year and used predominantly in your trade or business. That means it has to be more than 50 percent business use. We see this with business equipment such as computers and office equipment, generally that's 100 percent business use. The real issue is generally vehicles. Vehicles are not always 100 percent business use, and so you have to make sure that if it's more than 50 percent in order to take any kind of a Section 179 deduction on a vehicle. Also, vehicles have real stringent limits on Section 179 deductions, and you want to discuss that with your tax preparer. SUVs get a higher deduction than luxury autos. Luxury autos are autos that generally exceed $15,300 in cost, so that's pretty much just about any vehicle that you would want to

buy. So that is one thing to talk to your tax preparer about if you're thinking about buying new vehicles before the end of the year because you're not going to get as much bang for your buck on a vehicle, necessarily, as you would other business equipment.

C. Austin Fitts: Okay, so let's see, how to increase basis in S-Corp. A lot of subscribers do have S-Corp, so this is of great interest.

Patty Kemmerer: Yes, a lot of people. It's very hard for most business owners to get their head wrapped around what their basis in their S-Corporation really is. Their basis is basically what their investment in their corporation, and if the corporation has losses, that reduces their basis. You can only deduct losses up to the amount of your basis, and that's something that your tax professional should be keeping track of on a year-to-year basis to determine what that number is. If your losses exceed your basis, you can't deduct that – the total amount of that loss currently unless you do something to increase your basis. If you have a loss in your business, most likely your business could use some cash, so you could either loan money to your company or make a capital contribution to your company. Either one of those things will increase your basis in the company so that you can deduct more of the current year loss. Of course, the risk is that putting more money into your company makes more of your personal funds at risk, and you need to really consider before doing that whether or not the fact that your company has a loss this year is indicative of trouble ahead. If you feel like there are choppy waters ahead for your company, you may not want to put more money into it at the risk of losing the additional funds as well. So you do need to sit with your advisor and discuss whether or not this makes good fiscal sense for you, not just from a tax perspective, but also from a long-term investment perspective.

C. Austin Fitts: So, now, if you can't write off the losses this year, can you roll them over so they can't carry them.

Patty Kemmerer: You can carry them over. You certainly can. So they don't disappear; they just get deferred to a year when you have a profit to take the losses against.

C. Austin Fitts: Okay. So let's now go over expiring provisions. You said that there are 52 provisions set to expire. We're not going to go through all 52.

Patty Kemmerer: No, not at all. Let's just kind of hit the highlights. So, as you may recall, people who have had trouble in this economy with making their mortgage payments were allowed an exclusion for a discharge of their qualified principal residence indebtedness of up to $2 million if they lost their home, for example.

C. Austin Fitts: So let me explain what that means. What that means is if you lost your home or you were in a foreclosure and your mortgage was written off, that normally would have been – a write-off of indebtedness becomes a taxable event, and that's income to you. So what we're saying is up to $2 million that you basically had a get-out-of-jail-free card on that. That got relieved. So what we're saying is that, traditionally, if I had a mortgage on a home (and this applied to other indebtedness, not just mortgages), and the home was foreclosed on and the mortgage written off, that would be a taxable event that would be considered income to me; that the debt was written off, and what was provided by the federal government was relief for a certain period. So when that debt was written off, it wasn't considered a taxable event, and I didn't have to pay tax on a write-down of indebtedness, is that correct?

Patty Kemmerer: That is correct. Yes, forgiveness of debt has normally been a taxable event, but this law did exclude people who were in this situation as long as the debt was qualified principal residence. That is to say that it had to be your principal residence and it had to be debt that you used to purchase or improve your home. Some people have gotten caught with home equity debt that was not considered qualified principal residence debt. But in any case, that provision expires at the end of this year, so that is no longer going to be available.

C. Austin Fitts: Okay. Well I don't see how anybody can accelerate that into 2013.

Patty Kemmerer: No. No.

C. Austin Fitts: But clearly, if you need that, if you're in that situation, it's an unbelievably important thing to have.

Patty Kemmerer: But the other thing is, there's also been a provision that will still exist that if you are insolvent at the time of the debt discharge, then you also don't have to pay tax on it, so you know, as we go into 2014, if someone finds themselves in this situation and finds that they were insolvent at the time of the discharge of the debt, they still will not have to pay tax on the income from that discharge of debt.

C. Austin Fitts: Okay, well there's – sorry, go ahead.

Patty Kemmerer: Oh, I was just going to touch on a couple of others. One is the $250 deduction for expenses of school teachers. That's been around for several years now and school teachers are always dipping into their pockets to pay for things for their classrooms that the school system doesn't cover for them, and they've been allowed to claim up to $250 deduction for that on the front of their tax returns. That's another expiring provision. Those expenses will now go onto Schedule A as a miscellaneous itemized deduction subject to 2 percent of your adjusted gross income as unreimbursed employee business expense.

C. Austin Fitts: Okay, were there any others you wanted to mention?

Patty Kemmerer: The deduction for qualified higher education expenses is going to go away. The credit will still be there. There was an option where you could deduct the expenses on the front of your return or take a credit on Page 2. The deduction piece for the front of the return is expiring. So that will no longer be there.

C. Austin Fitts: Okay, and people can find a list of those on the – is it on the IRS web site?

Patty Kemmerer: It is not. It is www.jct.gov where you can go to look for that, and there's a whole list of them.

C. Austin Fitts: To deal with this complexity, the filing season for 2014 has been delayed?

PATTY KEMMERER: It has been delayed, and what that means is the IRS will not be able to process tax returns for 2013 at the date that they had originally anticipated, which was January 21st was when they were going to start processing. Because of the government shutdown in October of 16 days, which was their prime time for testing their systems and updating their software, they are going to have to postpone the date when they will start processing returns by up to two weeks. They will not be able to start processing any earlier than January 28th, and it could be as late as February 4th. They're supposed to come out this month with a definite date of when they will start processing, but they have not yet made that announcement.

"Because of the government shutdown in October of 16 days, which was their prime time for testing their systems and updating their software, they are going to have to postpone the date when they will start processing returns by up to two weeks."

C. AUSTIN FITTS: So what we're saying is our filing deadlines haven't changed, but their ability to generate a refund has slowed down.

PATTY KEMMERER: Yes, exactly. A lot of people like to file their tax returns immediately in January so that they can get their refunds, obviously, but the processing date has been pushed back, so you won't be able to get your refund as early in the year as you normally would.

C. AUSTIN FITTS: Okay, there were a couple of what I called red flags that I also wanted to touch on. A lot of our subscribers have foreign accounts, and because of that file FBAR reforms or what's called TIFIC filings. The one thing I just wanted to underscore is if you have foreign accounts, it's absolutely imperative that they be fully disclosed and if you're subject to an FBAR or any of these other forms, that you do it. What I find is not properly disclosing your foreign accounts can really cause some trouble. So in terms of keeping records, or making sure you or your CPA file those forms, you want to make sure you do it.

PATTY KEMMERER: Right, and those forms are due by June 30th of the year, by the way.

C. Austin Fitts: Right, the FBAR, but in the regular filings there's disclosure as well.

Patty Kemmerer: That's correct. At the bottom of Schedule B, you have to state whether or not you have any interest in foreign bank accounts.

C. Austin Fitts: Now the other thing, I know we mentioned charitable deductions but to me this is another red flag, is making sure you have proper documentation for all your deductions because I do think it's an area that has increased focus. Are there any others, Patty, that you think are important?

Patty Kemmerer: As far as red flags?

C. Austin Fitts: Yes.

Patty Kemmerer: Well, I can tell you this, depending on your income, the amount of your income may be more likely to trigger an audit. For example, people under $200,000 of income on their tax return, their audit chances are about 1.03 percent. People with incomes of over $200,000 have an audit rate of approximately 3.7 percent, or one out of every 27 returns are audited. People who report more than $1 million in income have a 1 in 8 chance of being audited, just because of the level of income they are reporting. You also have to be very careful to report everything that you receive a 1099 form because the IRS receives copies of all W-2s and 1099s, and they do have an automated matching program. So if you haven't reported something on your return that was reported to the IRS, you're much more likely to get audited on your return.

C. Austin Fitts: Now, let's say I file my taxes and then realize that I forgot to report something. I can always amend, right?

Patty Kemmerer: That's correct. You can file a Form 1040-X form to report that additional income and pay the tax on it. The IRS has up to three years to audit you, so sometimes people don't hear from the IRS for three years after they file their return and can't remember what they

did or didn't do at that point in time or where their papers got off to. So make sure that you keep your support for all your tax deductions and income for a minimum of three years.

C. Austin Fitts: What would you say would be advisable? Five years?

Patty Kemmerer: Generally I'd say five to seven years. If the IRS suspects fraud, if you've missed a big income item, if you've missed reporting it and the IRS suspects fraud, there is no limit. They can come back to you without limit, so I generally tell people to keep things for at least seven years.

C. Austin Fitts: Okay. Well, there are two drumbeats I constantly hammer on with subscribers and with clients, and that is if you want to be impeccable about records, you want to keep a record of everything. The other prejudice I have, which you know, is please don't do your taxes yourself. If there's any way you can get an accountant, a good accountant, to do them, I think it's really – we're now talking about a level of complexity that is extraordinary. Unless you are very good at this kind of stuff and really want to take the time, I think you just need somebody who's in the thin and thick of it. Since I'm not the CPA here, I'll bang that drum. I think it's very important that you keep good records and you tell them everything, you're fully disclosed, and then if a mistake happens, you know, mistakes happen in complex systems. But I think then, if you've made best efforts to be fully compliant, you don't run into trouble. I'm continually amazed running into subscribers who continue to think that there's such a thing as privacy in this financial system. Although, I would say that Mr. Snowden has done a lot to persuade everyone that privacy is not what he or she thought it was. So I just think it's very, very important to be as impeccable as possible, and if you are, then you sleep at night. I think it's a great investment to be impeccable in all this stuff and then you don't have to worry.

Patty Kemmerer: Absolutely. I agree 100 percent.

C. Austin Fitts: Okay. One other thing you mention which I just wanted to touch on was telephone scams because I hear more and more reports

of this. It hasn't happened to me personally, and I just thought maybe we should say a few things about it because if you look at what's going on on the internet or phones, the scamsters are clearly out.

PATTY KEMMERER: They are, and they're very sophisticated as well. They know more about you than you really think that they do, and what they're doing, it's a telephone scam. They call you and they say that you owe money to the IRS and that it must be paid promptly, either through a preloaded debit card or a wire transfer. If the victim refuses to cooperate, they threaten them with arrest, deportation or suspension of a business or driver's license. Some things you need to know is that the IRS never asks for credit card numbers over the phone. It never requests prepaid debit cards or wire transfers. They don't ask for PINs, passwords or any other similar confidential access information for credit card, bank or other financial account. Generally, the first contact with the taxpayer on an IRS tax issue is most likely to occur via regular snail mail, not e-mail. There are a lot of e-mails also that are coming out that appear to be from the IRS. Do not open any attachments if you receive e-mail that appears to be from the IRS, and you can forward the e-mail if you get it to phishing@IRS.gov, and that is P-H-I-S-H-I-N-G@irs.gov. So if you receive e-mail, please send it there.

Now, back to the telephone scam. They use fake names and IRS badge numbers, so they sound very official. They may be able to recite the last four digits of your Social. So generally, you're going to think, "oh, my, they must be really legitimate. They know my Social." Not true. They may know it, but they're still not legit. They can actually spoof the IRS toll-free number on your caller ID to make it appear that the IRS is the one that's calling, and after they call you, they may follow up with e-mail.

C. AUSTIN FITTS: Right. One of the things that I've discovered, because I've had to do this a lot over the last 15 years, is if you hang up and call the IRS, the IRS in my experience has very excellent customer service. Now, on a busy day, it may take a while to get through, but you can usually get through and you can get through to somebody who's competent and can handle your request. If you have any doubts, you can always hang up and just call the IRS.

PATTY KEMMERER: Right. So if you get one of the calls and you know you owe taxes or you think you might, you should call their 800-number, which is 800-829-1040. On the other hand, if they call and you know you don't owe any tax, they recommend that you call the Treasury Inspector General at 800-366-4484. They also advise that you should contact the FTC, the Federal Trade Commission, and use their FTC Complaint Assistant at ftc.gov and add the words IRS telephone scam to your comments in the complaint.

"They recommend that you call the Treasury Inspector General at 800-366-4484. They also advise that you should contact the FTC, the Federal Trade Commission, and use their FTC Complaint Assistant at ftc.gov and add the words IRS telephone scam to your comments in the complaint."

C. AUSTIN FITTS: Okay, now there's one more thing I wanted to go over, Patty. Don't laugh. This is important. When you send your taxes in, explain to us, in snail mail, what we should do. Should we have it registered, certified receipt? Should we just dump it in the mail? I want to make sure when we mail it that we have the proper proof that we sent it off.

PATTY KEMMERER: Right. You can always have a certified receipt. You don't necessarily need to send the green card, which is the card that they stamp it and send it back, unless that makes you feel more comfortable. But you do need proof of mailing. The filing date of April 15th, for example, if you mail your return on April 15th, it is considered timely filed. It doesn't have to be in their hands on April 15th, but if you were going to wait until April 15th to mail it, I would definitely get a receipt.

C. AUSTIN FITTS: Right. I live in an area where we're constantly having things disappear in the mail, so I just think you can't be too careful in terms of having the proof and having copies and keeping copies, so don't mail off your only copy.

PATTY KEMMERER: That's right. Make sure that you keep a copy so that you

know what you filed.

C. Austin Fitts: And you have good receipts. Okay, well, Patty, this has been very, very useful. Is there anything else just in summary you'd like to add before we close?

Patty Kemmerer: Well, as you mentioned, it's probably a good idea to not try this at home. Do try to find a competent CPA to handle preparation of your taxes. The best way to find someone is to get a referral from a friend or relative that has used someone that they trust. If you don't have the opportunity to get a referral because you don't have friends or relatives using a CPA, you can always contact the State Society of CPAs and get referrals from them, but definitely the complexity is great. Lots and lots of tax law changes. Do try to get someone to prepare your returns that knows what they're doing.

C. Austin Fitts: Right. I couldn't agree more. Well, Patty, it's been a pleasure to have you on The Solari Report. We know you're going to be busy. Between now and May is a very busy time.

Patty Kemmerer: Yes, it is.

C. Austin Fitts: Yes it is, so thank you for joining us on The Solari Report. Have a wonderful day.

Patty Kemmerer: My pleasure. Thank you for having me. You have a great day too.

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