BALL & ASSOCIATES
An Accountancy Corporation
1530 E. Shaw Avenue, Suite 109
Fresno, California 93710-8010
Telephone (559) 320-1040 • FAX (559) 320-0460
contactus@ballandassociates.com
www.ballandassociates.com

Inside this issue

Can partners be employees? 2
Partnership tax terms and what they mean 2
Study these work-related education tax breaks 3
Provide the right mix of employee benefits 3
Don't react badly to bad economic news 4

Tax & Business letter
FALL 2016

Health accounts – review your options

As you're reviewing your options for making changes to your benefits during your employer's open enrollment period, consider the differences between a health savings account (HSA) and a health care flexible spending account (FSA).

Overview

An FSA is generally established under an employer's benefits program. You can set aside a portion of your salary on a pre-tax basis to pay out-of-pocket medical expenses.

An HSA is a combination of a high-deductible health plan and a savings account in which you save pre-tax dollars to pay medical expenses not covered by the insurance. "High-deductible" means you pay more of your medical costs out-of-pocket. Generally, premiums on high-deductible plans are lower than traditional health insurance policies. To qualify as a high-deductible plan for 2016, the minimum deductible must be $1,300 for self-only coverage and $2,600 for family coverage.

Contributions

For 2016, you can contribute up to a maximum of $2,550 to an FSA. Typically, you have to use the funds by the end of the year. Why? Unused amounts are forfeited under what's commonly called the "use it or lose it" rule. However, your employer can adopt one of two exceptions to the rule, and offer either a two-and-a-half-month carryover period during which you can use the remaining funds, or allow you to carry over up to $500 into the following year.

If you are single, the 2016 HSA contribution limit is $3,350 ($6,750 for a family). You can add a catch-up contribution of $1,000 if you are over age 55. You do not have to spend all the money you contribute to your HSA each year. You can leave the funds in the account and let the earnings grow.

Earnings

FSAs are typically not considered actual "accounts" because your employer holds your money until you request reimbursement for qualified expenses. HSAs are savings accounts, and the money in the account can be invested. Earnings held in the account are not included in your income.

Withdrawals

Distributions from both accounts are tax- and penalty-free as long as you use the funds for qualified medical expenses. After age 65, the funds in your HSA can be used for any purpose without penalty.

Portability

Normally, your FSA stays with your employer when you change jobs. Your HSA belongs to you, and you can take the account funds with you from job to job. That's true even if your employer makes contributions to your HSA for you.

Because you generally can't contribute to both accounts in the same year, understanding the differences can help you make a decision that best fits your circumstances. Contact us for help as you consider your benefit choices. ◆

IRS TAX NOTES

Some tax refunds may be delayed

The *Protecting Americans from Tax Hikes Act of 2015* (PATH Act) will affect taxpayers who claim the Earned Income Tax Credit and the Additional Child Tax Credit on 2016 federal income tax returns. Under the law, the IRS is required to hold refunds on returns claiming those credits until February 15, 2017, as an identity theft deterrent. While returns will be accepted if filed earlier, the entire refund will be delayed.

"Unforeseen" equals partial exclusion

Generally, single taxpayers can exclude up to $250,000 of gain from the sale of a home, and married taxpayers can exclude up to $500,000, when the home is used as a primary residence for two years in a five-year period that ends on the date of sale. Tax law also provides for a partial exclusion when the time and ownership requirements are not met, if the primary reason for the sale is unforeseen circumstances. "Unforeseen" means events the taxpayer could not have reasonably anticipated before buying the home and moving in. How flexible is the definition? Recently, the IRS allowed a partial exclusion when a family living in a two-bedroom, two-bath condominium gave birth to another child and needed a larger residence before the two-year rule was met.

No exception for cash incentives

Cash and cash equivalent incentives and rewards are taxable income to employees, no matter the amount. Is that also true of cash rewards for participating in a wellness program? The IRS says yes, for cash, cash equivalents, and items such as gym memberships and reimbursements for the wellness program premium. ◆

Can partners be employees?

Suppose you're a partner in a partnership where the agreement requires you to work some of the time for the business. Can you ever be treated as an employee of the partnership for tax purposes instead of as a partner? The lines may become blurry, but the IRS has maintained, at least up until this point, that partners aren't employees.

New regulations concerning disregarded entities shed some light on this issue. Traditionally, the IRS has said that if you're a partner who provides services to the partnership, you aren't treated as an employee of the partnership. The regulations clarify that this result can't be avoided if you become an employee, based on state law, of a single-member limited liability company owned by the partnership.

What is the tax significance? Unlike corporations, partnerships pass through items of income and loss to partners. You report the appropriate share on your personal tax return. Instead of receiving Forms W-2 as employees do, the partnership issues a Schedule K-1, *Partner's Share of Income, Deductions, Credits, etc.*, to partners. In addition, you must pay income tax on guaranteed payments made during the year even though you don't receive a taxable salary. Guaranteed payments are amounts paid to partners no matter the partnership's income.

Similarly, although employment taxes aren't deducted from wages, you pay equivalent self-employment taxes. The tax rate is double the usual rate for employees, but half of the amount is deductible on your return.

This tax structure can be problematic if fringe benefits are provided to workers. Because you, as a partner, aren't treated as an employee, you generally aren't eligible for the tax exclusion for certain statutory fringe benefits. That means the fringe benefit payments can represent taxable income to you.

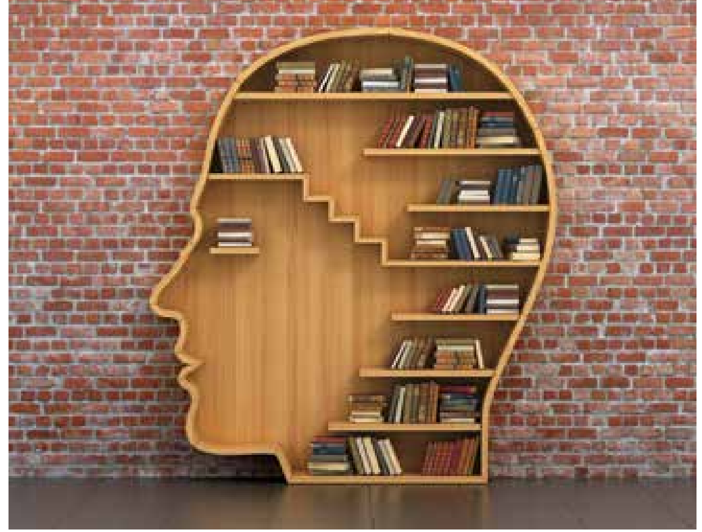
Do you have questions about how your business ventures affect your tax return? Contact us for help. ◆

Partnership tax terms and what they mean

Puzzled by tax-related partnership lingo? Here's the definition of key terms in partnership tax rules.

- **Guaranteed payments.** Payments made to partners during the year regardless of whether the business is profitable.
- **Schedule K-1.** The tax form used to report items of income, loss, and partnership activities to partners.
- **Limited liability company (LLC).** A legal business entity, similar to a partnership, where the members have no personal obligation to pay company debts.
- **Partner.** One of the individual parties in a partnership.
- **Partnership.** An unincorporated business made up of two or more entities who engage in an activity for profit. Income and loss of the partnership are passed through to the partners. For tax purposes, a partnership may differ from a joint venture, which is generally a joint undertaking to share expenses.
- **Partnership agreement.** A legally binding agreement between partners detailing the business relationship. Amendments are considered part of the original agreement. ◆

Study these work-related education tax breaks



Education deductions and credits aren't only for college students. Some deductions are available for employees, employers, and the self-employed. Here's a quick review.

Employees

As an employee, your work-related education expenses may qualify for credits such as the Lifetime Learning Credit. You don't need to be pursuing a degree to qualify for the Lifetime Learning Credit, but the school needs to be an eligible educational institution. If you receive education benefits from your employer, those amounts are not eligible for the credit.

When the courses you take improve or maintain your current job skills and your employer does not reimburse the costs, you also have the option of claiming a miscellaneous itemized deduction. As a general rule, to be considered "work-related," the education can't qualify you for a new career, trade, or business.

Employers

As an employer, you can pay for graduate and undergraduate education expenses for your employees using a written educational assistance plan. By establishing a nondiscriminatory formal plan, you can claim a federal tax deduction for up to $5,250 of expenses annually. Your employee isn't required to include the benefit as income. Don't have a written plan? You can still pay for or reimburse expenses such as seminars that maintain or improve required skills, or expenses required under law for the employee to keep the same job.

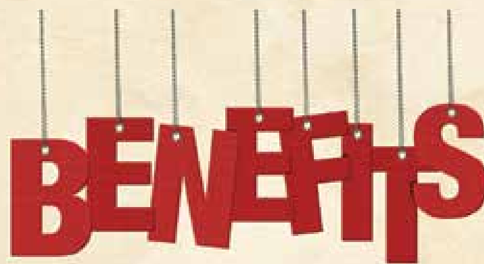
Self-employed

When you're self-employed, you can deduct expenses for qualifying work-related education from your self-employment income. You don't have to itemize deductions to claim the expenses.

In general, a connection between your present job and the education expenses is important in order to benefit from tax breaks. Contact us for details and assistance in determining which expenses will qualify. ◆

Provide the right mix of employee benefits

Does your workforce include a variety of age groups, with some employees just beginning careers, and some getting ready to retire? If so, you may be scrambling to provide the right mix of benefits. Here's a sampling of offerings that you might want to consider.



- **"Voluntary" insurance.** Insurance that can extend regular medical coverage, but that you're not required to provide, such as life, dental, vision, accident, disability, and critical illness, can help employees cope with unexpected costs. You may also want to investigate supplemental "gap" insurance if the health policy you offer has a high deductible. A telemedicine benefit that allows employees to obtain medical advice for common ailments via live video access to a medical professional may also be of value in reducing sick time taken for in-person doctor visits.
- **Flexible scheduling.** Flexibility benefits include variable work schedules, paid time off banks, and performance-based pay and bonuses. Telecommuting may also be an option.
- **Wellness programs.** Improving the health of your employees by offering initiatives such as screenings and weight loss classes may help reduce stress and save on health care costs. You can offer employees financial or non-financial incentives to participate, including prizes and gifts. Just be aware that these programs are subject to anti-discrimination rules as well as requirements to protect personal health information. The rules apply to all workplace wellness programs, and go into effect in 2017.
- **Financial health.** Communicating your company's benefits, automatic enrollment in retirement plans, and assistance with student loans can keep employees from getting sidetracked with financial concerns.

Fringe benefits can be a powerful tool for attracting and retaining staff. Contact us about tax implications before you initiate changes to your benefit program. We'll help you determine what options offer the most value for you and your employees. ◆

Don't react badly to bad economic news

Reacting badly to bad national economic events can turn a challenging situation into a devastating one. When troubling headline news comes your way, consider these tips before making financial moves.

• **Don't be an average investor.** Economists have noted that even in good times average investors usually fail to benefit fully from a market upswing. The reason: not staying invested for the duration of the cycle. Average investors tend to bail out when the future looks troubling, in essence "locking in" losses. Good investing techniques can be as much about mental toughness as about financial acumen.

• **Focus on costs.** Periods of economic uncertainty are also a good time to focus on costs, especially in a low-return environment. Make sure you're not overpaying for fund management or sales commissions. And be mindful of tax costs too, which can have a deadly effect on overall returns. If you decide to sell a stock in a taxable account, consider choosing one you have held for a year or more to qualify for the long-term capital gain tax rate. A market downturn might provide an opportunity to harvest capital losses to help offset previous gains.

• **Revisit your tax planning.** Unfavorable economic news might require a tweak to your tax planning. Lower anticipated income could justify reduced estimated tax payments or withholdings. If you're retired, consider deferring retirement account withdrawals or changing the type of investments you were planning to liquidate. A midyear review of your tax situation is always a smart move.

The bottom line: Don't make a bad economic situation worse. Contact our office for help in navigating the current financial environment. ◆

NOTE: *This newsletter is issued quarterly to provide you with an informative summary of current business, financial, and tax planning news and opportunities. 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.*

©MC

We appreciate your business. Please call any time we can be of assistance to you in your tax, financial, or business affairs.

BALL & ASSOCIATES • (559) 320-1040

SEPTEMBER 15 – Due date for individuals to pay third quarter installment of 2016 estimated tax.

SEPTEMBER 15 – Deadline for filing extended 2015 tax returns for calendar-year corporations.

SEPTEMBER 15 – Deadline for filing extended 2015 partnership and limited liability company returns.

OCTOBER 17 – Filing deadline for extended 2015 individual tax returns.

OCTOBER 17 – If you converted a regular IRA to a Roth IRA in 2015 and now want to switch back to a regular IRA, you have until this date to do so without penalty.

NOVEMBER

During November – Estimate your 2016 income tax liability and review your options for minimizing your 2016 taxes. Call us to schedule a tax planning review. ◆