Newsletter
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TYLER ✦ LYNCH PC

CERTIFIED PUBLIC ACCOUNTANTS | BUSINESS CONSULTANTS

INSIDE THIS ISSUE

- College Planning
- Qualified Dividends
- Self-employed or Employee?
- Tax Audit
- Hire Your Child

www.TylerLynchPC.com 617.354.3814

Tax Planning for College

With the rising costs associated with sending your children to college, early financial planning can be very helpful. If you take maximum advantage of tax benefits described in detail below, you can minimize your costs. (Please note that the following suggestions apply strictly to tax benefits and non-tax-related concerns may make the suggestions inappropriate.)

Planning for college expenses:

- **Transfer ownership of assets**: You and your spouse can transfer up to $26,000 in 2012 in cash or assets to each child with no gift tax consequences.
- **Tax-exempt bonds**: Invest in tax-exempt bonds that will grow to a sizable fund by the time your child reaches college age.
- **Series EE US savings bonds**: For Series EE US savings bonds, you don't have to report interest on the bonds for federal tax purposes until the bonds are cashed in. Interest on "qualified" Series EE bonds may be exempt from federal tax if the bond proceeds are used for qualified college expenses.
- **Qualified tuition programs**: With a qualified tuition program established by the state government or private education institutions, you can buy tuition credits for your child or make contributions to an account. Contributions are treated as taxable gifts but eligible for the gift tax exclusion. Earnings on contributions accumulate tax free until the college costs are paid from the funds.

(continued on page 2)

Tax Advantages of Qualified Dividends

What are qualified dividends?

- Qualified dividends: dividends paid by a US corporation or a qualified foreign corporation that are not specifically excepted from a qualified dividend treatment on stock that a taxpayer has held for a certain period; subject to capital gains tax rates

To treat dividends paid on a stock as qualified dividends:

- Must hold on to the stock for at least 61 days during the 121-day period that began 60 days before the ex-dividend date
- Ex-dividend date: the first date on which the stock buyer will not receive the dividend paid on behalf of the shares being sold

What are the tax advantages of qualified dividends?

- If you hold the stock 60 days during the period you owe tax at a 0% or a 15% rate (0% if you are a low-income investor)
- If you sell too soon, you will owe tax at your ordinary income tax rate
- The same rules apply to preferred stock, but the numbers are 91 and 181 days to owe tax at the low rates

How long will this last?

- These laws only apply until 2013; beginning in 2013, qualified dividends are set to be taxed at ones' ordinary income rate

(continued from page 1)

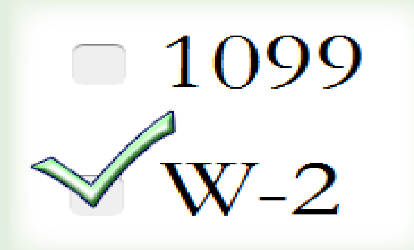
- **Coverdell education savings accounts**: You can make contributions up to $2,000 for each child under 18. Contributions aren't taxed and distributions are tax-free if spent on qualified education expenses.

Once your child reaches college age, your focus shifts from planning to actually paying college expenses. The following tax benefits may be of interest:

- **Tuition tax credits**: You can take an American Opportunity tax credit up to $2,500 per student for the first 4 years of college. Additionally, you can take a Lifetime Learning credit up to $2,000 per family for every additional year of college or graduate school. Only one credit may be claimed for the same student in a given year.
- **Scholarships**: Scholarships are exempt from income tax if certain conditions are satisfied—the most important condition being that the scholarship is used for educational purposes (i.e. tuition, books, fees, etc.) not room and board.
- **Employer educational assistance programs**: If your employer pays your child's college expenses, the payment is a fringe benefit to you and is taxable as compensation.
- **College expense payments by grandparents and others**: If payment is made directly to the educational institution, there is an unlimited exclusion from the gift tax for the payment.
- **Student loans**: You can deduct interest on loans used to pay your child's education at a post-secondary school. The maximum deduction is $2,500.
- **Withdrawal from retirement plan accounts**: You can withdraw money from your IRA at any time to pay college costs without incurring the 10% early withdrawal penalty. Distributions are subject to tax.

For a better analysis of your particular situation and specific details on applicable tax benefits, please call us at 617-354-3814.

Independent Contractor or Employee?



Whether your worker is classified as an independent contractor or an employee impacts federal income and employment taxes.

If your worker is an employee, the company must:

- Withhold federal income and payroll taxes
- Pay the employer's share of FICA taxes on the wages plus FUTA tax
- Provide the worker with fringe benefits it makes available to other employees

In addition, there may be state obligations.

On the other hand, if your worker is an independent contractor these obligations do not apply. For an independent contractor, the company must only:

- Send the independent contractor a Form 1099-MISC for the year showing what he/she was paid (provided it amounts to $600 or more)

Determining which way your worker should be classified is not as simple. There is no uniform definition of the term "employee." Under common-law rules an individual is considered an employee if the enterprise has the right to control and direct him on the job to do and how to do it. Individuals specifically identified by the IRS as employees ("statutory employees"), are treated as employees for tax purposes regardless of the company's degree of control. In some cases, you may ask the IRS to rule on whether your worker is an independent contractor or an employee.

Tax Audits

Hundreds of thousands of individual tax returns are audited by the IRS each year to verify the reported items. The best way to survive a tax audit is to prepare in advance. Organization is crucial; you must maintain documentation for items reported on your return and keep your records together in an orderly fashion so you can easily present them to an IRS agent. It can be quite beneficial to have a tax professional represent you at an audit because he or she is likely to know the issues an IRS agent may focus on and can prepare accordingly.

Hiring Your Child

If your child is looking for a summer job and your business could use a little extra help, you can fulfill both your needs by hiring your child. As an added bonus, you can collect tax breaks as a family.

In hiring your child, he or she is treated as any other employee. As a result, he or she can usually receive the same fringe benefits. As for your company, the compensation paid to your child is fully deductible. In addition, you can cut your overall tax bill through family income-splitting.

(continued on page 4)

(continued from page 3)

For example, suppose you hire your 18-year-old child and pay a summer salary of $5,000 that would have otherwise been included in your taxable income. Assuming your child earns no other income, he or she pays no income tax because the standard deduction for 2012 is $5,950. Supposing you fall in the 33% tax bracket, your family saves $1,650 in taxes (33% of $5,000).

Other potential tax breaks include:

1. Insurance plans: Under a group plan, you can provide health insurance coverage to your child. The health insurance protection is 100% tax-free. Additionally, the first $50,000 of group-term life insurance coverage paid on behalf of your child is tax-free. Premiums paid by your business for the insurance plans are tax deductible.

2. Retirement plans: As an employee, your child is now eligible to participate in your 401(k) or other qualified retirement plan.

3. IRAs: With earnings from this summer job, your child can now save up to $5,000 in a traditional or Roth IRA for 2012. Since the income is low, the traditional IRA contributions are deductible on your child's personal return.

4. FICA and FUTA: For a child under age 18 employed by a parent's sole proprietorship or by the parents' husband-wife partnership, the child's wages are exempt from the Social Security and Medicare taxes. There is also an exemption applied to the FUTA tax for a child under the age of 21.

These potential tax breaks can result in significant savings for families.

IF YOU WOULD LIKE MORE INFORMATION ON THESE TOPICS OR IF YOU WOULD LIKE TO READ UP ON OTHER RELEVANT TOPICS, PLEASE REFER TO OUR WEBSITE AT WWW.TYLERLYNCHPC.COM

Join Connect

Call us @ 617.354.3814

186 Alewife Brook Parkway, Suite 200
Cambridge MA 02138