

# Client Bulletin

Smart Tax, Business & Planning Ideas *from your Trusted Business Advisor*<sup>SM</sup>

## Tax Breaks for Supporting a Parent

February 2013



### Tax threshold

If you are in the previously mentioned situation, you should try to take advantage of all possible tax benefits. The money you save in taxes may be invested for your retirement.

For example, you might be able to claim a dependency exemption for a parent you're supporting. You'll get a tax deduction of \$3,900 in 2013 (estimated as of this writing) for each exemption you claim. Depending on your tax bracket, you might save well over \$1,000 for each dependent.

The fabled Baby Boom began in 1946, right after World War II. Therefore, the oldest Baby Boomers reached 66 in 2012, which is now the full retirement age for Social Security. As millions of Boomers near and reach retirement, however, many are feeling family-related financial strains.

A recent survey by Ameriprise Financial found that many Boomers provide aid to their elderly parents. For example, 22% of respondents help their parents to buy groceries, 15% aid with medical bills, and 14% contribute to outlays for utility bills. Some Boomers reported that these expenses have reduced the amount they save for their own retirement.

To get a dependency exemption for a parent as a "qualifying relative," you must pass several tests. For example, your dependent must have less than an estimated \$3,900 in gross income this year. Tax-exempt income doesn't count as gross income, and that includes certain Social Security benefits.

**Example 1:** Ken and Carol Grant help to support Carol's widowed mother, Helen. In 2013, Helen collects \$8,000 in Social Security benefits. Her only other income comes from bank account interest, which is minimal.

Under the tax code, a single taxpayer owes no income tax on Social Security benefits if *combined income* (adjusted gross income plus nontaxable interest

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## Plumpest Pension

*The maximum Social Security benefit for a worker retiring at full retirement age (66 in 2013) is now \$2,533 a month, about \$30,400 a year.*

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plus half of Social Security benefits) is less than \$25,000. Helen's total is under the threshold, so her Social Security benefits are not taxable and not included for this calculation. Thus, Helen meets the income test to be treated as a dependent.

### Counting costs

Besides the income test, you must provide over half of the dependent's support. That is, you must pay more than 50% of the amounts spent on the other person's food, lodging, clothing, education, medical and dental care, recreation, transportation, and similar necessities.

**Example 2:** In 2013, Carol's mother, Helen, spends a total of \$18,000 for necessary living expenses listed previously. If Ken and Carol provide over 50% of that amount—\$9,000—they pass this test for claiming Helen as a dependent.

If Helen lives with Ken and Carol, the Grants will find it easier to pass this 50% support test. That's because they can include the fair rental value of the housing they provide in the total of their contributions. If Helen would pay \$1,000 a month to rent comparable lodging from a third party, yet she lives with the Grants rent free, then Ken and Carol can include that \$1,000 a month in the support they provide: \$12,000 a year.

### Addition to deductions

If your parent qualifies as a dependent, the tax savings may go beyond the dependency exemption. You also might be able to get a medical deduction. Money you spend for a dependent parent's qualified health care costs can be added to your own medical bills, increasing your chances for an itemized medical deduction. You also may be able to include a parent's medical expenses on your tax return even if that parent is not a dependent, as long as you provided over half of his or her support during the year.

The income and support tests, as described, are the keys to claiming a parent as a dependent for tax purposes. Other criteria apply; some taxpayers may receive reduced exemption amounts, depending on current law, and some taxpayers are shut out from any dependency exemptions.

In essence, the rules in this area are quite complex, even by the standards of the Internal Revenue Code. Our office can help you deal with all the fine print and show you how to claim parents or other loved ones as dependents, if that would be practical.

### Multiple method

In some families, more than one sibling will help to support an elderly parent. Then, no one taxpayer

may qualify for the dependency exemption.

**Example 3:** While the Grants help to support Carol Grant's mother, as described, Carol's brother Jeff also helps their mother, Helen, to make ends meet. Even though Jeff and the Grants together provide over 50% of Helen's support this year, neither taxpayer is over the 50% mark.

In such a situation, if all other hurdles are cleared, the contributing parties can agree to allocate the dependency exemption to one taxpayer. The taxpayer claiming the exemption must receive from each taxpayer eligible to claim the exemption a signed statement waiving his or her right to claim the person as a dependent for the year. The taxpayer claiming the exemption must attach to his or her return for the year he or she is claiming the exemption a statement that (1) identifies all the taxpayers eligible to claim the person as a dependent and (2) indicates that he or she has received a signed waiver statement from each of these taxpayers. IRS Form 2120 can be used for this purpose.

Assuming they contribute equal amounts, Jeff and the Grants can alternate so that they take turns claiming Helen as a dependent every other year. ■

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## Covered Calls Offer High Yields but Limit Gains

The Federal Reserve has promised to keep short-term interest rates low until at least 2015. Therefore, investors have scant hope that bank accounts, money market funds, or high-quality bonds will soon offer higher yields. Investors who seek significant current cash flow might consider selling so-called "covered calls" on stocks they own.

Investors can trade listed options on many stocks and exchange-traded funds. For example, you can buy or sell put or call options on stocks issued by companies such as Apple, Bank of America, and Intel. The owner of a call option has the opportunity to buy, while the owner of a put option has the opportunity to sell the underlying security. For

increased cash flow, you can sell ("write," as options traders say) one of these options and collect an upfront premium payment.

**Example 1:** Meg Lawson thinks that ABC Corp.'s stock will not go up much in the near future but also will not drop by much. Rather than put \$2,000 into a money market

fund, she uses that money to buy 100 shares of ABC trading at \$20.

To implement a “buy-write” strategy, Meg then sells one call on ABC (a call option covers 100 shares). Meg chooses to sell an option that will expire in three months, with a \$22 “strike” (purchase) price. This option is listed at 50 cents, meaning that Meg will receive \$50 for selling the call: 50 cents times 100 shares. The option Meg has sold is a “covered” call because she owns the shares to meet any exercise of this option.

### Possible outcomes

Suppose the three months pass, and ABC’s stock has traded between \$19 and \$21. The call option will expire—the owner of the option won’t exercise the right to buy at \$22 a share. Meg has received a 2.5% return on her investment (\$50/\$2,000) in three months, for a 10% annualized return. She’ll also collect any dividend ABC has paid in those three months, boosting her return. (This simplified example ignores Meg’s trading costs.) If Meg wishes, she can keep selling calls and keep collecting option premiums.

**Example 2:** Meg sells a three-month, \$22 covered call on ABC, as described. Here, ABC goes up to \$25 a share within three months. Thus, the owner of the call exercises the option, buying Meg’s 100 shares for \$22 apiece. Meg has a 10% profit on

the stock (bought for \$2,000, sold for \$2,200) in addition to the option premium she collected plus any dividends.

### Tracking the tradeoff

From the examples in this article, you can see both the pros and cons of covered calls. Selling these options offers you a way to increase your investment income. If you sell options with a strike price higher than the trading price (an “out of the money” call), you’ll retain some opportunity to profit, if the shares are called away.

However, in our example, Meg has capped her profit at \$2 per share. If ABC keeps climbing past \$25 to \$30 or \$35 a share, Meg won’t participate in those gains. It’s true that Meg can buy back the call and keep her ABC shares. She’ll take a loss on the option trades, though.

What’s more, Meg has no guarantee that her ABC shares will stay flat or rise. If the price drops, and Meg sees her \$2,000 investment fall to \$1,800, \$1,600, or lower, her \$50 option premium won’t offset her loss.

Thus, selling covered calls won’t guarantee superior investment results. That said, this strategy can be useful to stock market investors who fully understand the risks and potential benefits. With yields at historic low levels and the likelihood of staying that way for a while, you may find it worthwhile to investigate this technique. ■

## Business Owners Should Consider a Real Estate Purchase and Leaseback

If you’re a business owner, your company might own an office building, a warehouse, or other property. Assuming your company has owned the property for many

years, the real estate may be generating few if any depreciation deductions. In such a situation, consider buying the property personally, perhaps using borrowed

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## Trusted Advice

### Tax Treatment

- ❖ For investors, if an option you write on a stock is not exercised or repurchased, the amount you receive is a short-term capital gain. That gain is included in your income when the option expires.
- ❖ If a call you write is exercised, and you sell the underlying stock, increase the amount you receive on the sale by the amount you received for the call when figuring your gain or loss. The gain or loss is long or short term, depending on your holding period for the stock.
- ❖ If you enter into a closing (buyback) transaction by paying an amount equal to the current value of the call, the difference between the amount you pay and the amount you receive for the call is a short-term capital gain or loss.

## Did You Know?

**C**rowdfunding and Internet offers top the list of new investment scams. Federal provisions related to crowdfunding, a method for startups seeking capital, will not be available until later this year. Even when the new rules are effective, investments in small businesses may be more prevalent but not less risky.

*Source:* North American Securities Administrators Association



funds. Then your company can lease the property from you, so it will have continued use of the real estate.

### Bountiful benefits

Such a transaction can have advantages for you and for your company. The company will receive cash for expansion, hiring, and so on, even after paying tax on the gain. Ongoing lease payments from the company to you will be deductible for the company, replacing depreciation deductions that may have declined or disappeared altogether.

At the same time, you'll receive leasing income from the company. You'll have just purchased the real estate, in this scenario, so you'll be able to start a new depreciation schedule, and the depreciation



deductions can reduce the tax you'll owe from this income stream.

### Clearing the hurdles

To obtain these benefits, you must enter into a valid sale and leaseback. Here are the relevant rules:

- You should pay a fair price for the building. Today's depressed real estate market and low

mortgage rates might make it easier for you to buy the property.

- The lease payments should be comparable to what unrelated parties are paying for similar leases. Any lease renewals also must be set at fair rental value.
- Any repurchase option also must be at fair market value.
- The property's useful life must be longer than the term of the lease.
- You as the buyer must reasonably expect to make money on the deal, and you must have some risk of losing money.

Buying property from your company at a fair price in today's environment might turn out to be a good investment—one made even better because of multiple tax benefits. ■

## TAX CALENDAR

### FEBRUARY 2013

#### February 15

**Individuals.** If you claimed exemption from income tax withholding last year on the Form W-4 you gave your employer, you must file a new Form W-4 to continue your exemption for another year.

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

#### February 16

**Employers.** Begin withholding income tax from the pay of any employee who claimed exemption from withholding in 2012 but did not give you a new Form W-4 to continue the exemption for 2013.

#### February 28

**All businesses.** File information returns (for example, Forms 1099) for certain payments you made during 2012. If you file the forms electronically (not by magnetic media), your due date for filing them with the IRS is April 1.

**Employers.** File Form W-3, along with Copy A of all the Forms W-2 you issued for 2012. If you file Forms W-2 electronically (not by magnetic media), your due date for filing them with the Social Security Administration is April 1.

### MARCH 2013

#### March 15

**Corporations.** File a 2012 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 2012 calendar year income tax return (Form 1120S) and pay any tax due. Provide each shareholder with a copy of Schedule K-1 (Form 1120S) 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 to choose to be treated as an S corporation beginning with calendar year 2013. If Form 2553 is filed late, S corporation treatment will begin with calendar year 2014.

**Electing large partnerships.** Provide each partner with a copy of Schedule K-1 (Form 1065-B) 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.