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Newsletter May 2019

Thank You!

Along with our newsletter this month, we wanted to express our sincere appreciation to all of our clients and business contacts who helped to make this a successful spring tax season. We are so grateful for the kindness and patience that was shown to us during these long, busy days and weeks. We appreciate the opportunity extended to us and thank you for the trust placed in us.

Read This before Tossing Old Tax Records!

Generally, tax records are retained for two reasons: (1) in case the IRS or a state agency decides to question the information on your tax returns or (2) to keep track of the tax basis of your capital assets, so that you can minimize your tax liability when you dispose of those assets.

With certain exceptions, the statute of limitations for assessing additional taxes is **three years** from the return's due date or its filling date, whichever is later. However, the statute in many states is one year longer than that of federal law. In addition, the federal assessment period is extended to six years if more than 25% of a taxpayer's gross income is omitted from a tax return. In addition, of course, the three-year period doesn't begin elapsing until a return has been filed. There is no statute of limitations for the filing of false or fraudulent returns to evade tax payments.

That means you can probably discard most of your tax records that are more than seven years old.

The problem with discarding all of the records for a particular year is that many taxpayers combine their normal tax records with the records that substantiate the basis of their capital assets. The basis records need to be separated and should not be discarded until after the statute has expired for when a given asset was disposed of. Thus, it makes more sense to keep separate records for each asset. The following are examples of records that fall into the basis category:

• Stock-acquisition data – If you own an investment, keep the purchase records until at least four years after the year when you sell or dispose of the investment. This data is necessary for proving the amount of profit (or loss) from the disposition. If your disposition for a given year result in a net loss of more than $3,000, you may need to keep your purchase and sale records for even longer. This is because $3,000 is the maximum capital loss that can be deducted in any one year, so the excess loss must be carried over to the following year(s) until it is used up. If the IRS audits a return that includes a carryover loss, it will ask to see the records from the original purchase, even if it happened more than three years in the past. Thus, don't dispose of such records until the statute of limitations has passed for the last year when you claimed a carryover loss.

• Stock and mutual fund statements (if you reinvest dividends) – Many taxpayers use the dividends that they receive from stocks or mutual funds to buy more shares of the same stock or fund. These reinvested amounts add to the basis of the property and reduce the gain when They are eventually sold. Keep all such dividend statements for at least six years after the final sale.

• Tangible property purchase and improvement records – Keep records of home, investment, rental-property, or business-property acquisitions; the related capital improvements; and the final settlement statements from the sale for at least four years after the underlying property is sold.

For example, when Congress instituted the large $250,000 home-sale-gain exclusion (which is $500,000 for married couples filing jointly) many years ago, homeowners began to be laxer in maintaining their home-improvement records, thinking that the large exclusions would cover any potential appreciation in their home's value. Now, that exclusion may not always be enough to cover the gains from a sale, particularly for markets where property values have steadily risen; thus, keeping records of all such home improvements is vital.

What about the Tax Returns Themselves? Although the backup documents that you use to prepare your returns can usually be disposed of after the appropriate period has expired, you may want to consider indefinitely keeping a copy of the tax returns themselves (the 1040, the attached schedules/statements, and the state return). If you just don't have room to keep copies of your paper returns, digitizing them is an option.

If you have questions about whether to retain certain records, give this office a call. Before discarding any records, it is a good idea to make sure that they will not be needed down the road.

Gift and Estate Tax Primer

The tax code places limits on the amounts that individuals can gift to others (as money or property) without paying taxes. This is meant to keep individuals from using gifts to avoid the estate tax that is imposed upon inherited assets. This can be a significant issue for family-operated businesses when the business owner dies; such businesses often have to be sold to pay the resulting inheritance (estate) taxes. This is, in large part, why high-net-worth individuals invest in estate planning.

Exemptions – Current tax law provides both an annual gift-tax exemption and a lifetime unified exemption for the gift and estate taxes. Because the lifetime exemption is unified, gifts that exceed the annual gift-tax exemption reduce the amount that the giver can later exclude for estate-tax purposes.

Annual Gift-Tax Exemption – This inflation-adjusted exemption is $15,000 for 2018 and 2019 (up from $14,000 for 2013–2017). Thus, an individual can give $15,000 each to an unlimited number of other individuals (not necessarily relatives) without any tax ramifications. When a gift exceeds the $15,000 limit, the individual must file a Form 709 Gift Tax Return. However, unlimited amounts may be transferred between spouses without the need to file such a return – unless the spouse is not a U.S. citizen. Gifts to non citizen spouses are eligible for an annual gift-tax exclusion of up to $155,000 in 2019 (up from $152,000 in 2018).

If any individual gift exceeds the annual gift-tax exemption, the giver must file a Form 709 Gift Tax Return. However, the giver pays no tax until the total amount of gifts in excess of the annual exemption exceeds the amount of the lifetime unified exemption. The government uses Form 709 to keep track of how much of the lifetime unified exemption that an individual has used prior to that person's death. If the individual exceeds the lifetime unified exemption, then the excess is taxed; the current rate is 40%.

Gifts for Medical Expenses and Tuition – An often-overlooked provision of the tax code allows for nontaxable gifts in addition to the annual gift-tax exclusion; these gifts must pay for medical or education expenses. Such gifts can be significant; they include

- *tuition payments made directly to an educational institution (whether a college or a*

private primary or secondary school) on the donee's behalf – but not payments for books or room and board – and

- *payments made directly to any person or entity who provides medical care for the donee.*

In both cases, it is critical that the payments be made directly to the educational institution or health care provider. Reimbursements to the donee do not qualify.

Lifetime Exemption from Gift and Estate Taxes – The gift and estate taxes have been the subject of considerable political bickering over the past few years. Some want to abolish this tax, but there has not been sufficient support in Congress to actually do that; instead, the inflation-adjusted lifetime exemption amount has been increasingly annually. In 2019, the lifetime unified exemption is $11.4 million per person. By comparison, in 2017 (prior to the recent tax reform), the lifetime unified exemption was $5.49 million. The lifetime exemption for the gift and estate taxes has not always been unified; in 2006, the estate exclusion was $2 million, and the gift exclusion was $1 million. The tax rates for amounts beyond the limit have varied from a high of 46% in 2006 to a low of 0% in 2010. The 0% rate only lasted for one year before jumping to 35% for a couple of years and then settling at the current rate of 40%.

This history is important because the exemptions can change significantly at Congress's whim – particularly based on the party that holds the majority.

Spousal Exclusion Portability – When one member of a married couple passes away, the surviving member receives an unlimited estate-tax deduction; thus, no estate tax is levied in this case. However, as a result, the value of the surviving spouse's estate doubles, and there is no benefit from the deceased spouse's lifetime unified tax exemption. For this reason, the tax code permits the executor of the deceased spouse's estate (often, the surviving spouse) to transfer any of the deceased person's unused exclusion to the surviving spouse. Unfortunately, this requires filing a Form 706 Estate Tax Return for the deceased spouse, even if such a return would not otherwise be required. This form is complicated and expensive to prepare, as it requires an inventory with valuations of all of the decedent's assets. As a result, many executors of relatively small estates skip this step. As discussed earlier, the lifetime exemption can change at the whim of Congress, so failing to take advantage of this exclusion's portability could have significant tax ramifications.

Qualified Tuition Programs – Any discussion of the gift and estate taxes needs to include a mention of qualified tuition programs (commonly referred to as Sec 529 plans, after the tax-code section that authorizes them). These plans are funded with federally nondeductible contributions, but they provide tax-free accumulation if the funds are used for a child's postsecondary education (as well as, in many states, up to $10,000 of primary or secondary tuition per year). Contributions to these plans, like any other gift, are subject to the annual gift-tax exclusion. Of course, these plans offer tax-free accumulation, so it is best to contribute funds as soon as possible.

Under a special provision of the tax code, in a given year, an individual can contribute up to 5 times the annual gift-tax exclusion amount to a qualified tuition account and can then treat the contribution as having been made ratably over a five-year period that starts in the calendar year of the contribution. However, the donor then cannot make any further contributions during that five-year period.

Colorado 529 Contributions – If you are a resident of the State of Colorado and make contributions to the Colorado sponsored 529 plan, then you may be eligible to claim a state deduction for computing your Colorado tax liability. If this applies to you, please be sure to keep good records showing the contributions into the qualifying Colorado based 529 account and copies of the statements showing the funds moving from your account to the 529 account. The state of Colorado has had difficulty matching up contributions with the deductions claimed on returns and will often send a tax notice requiring the taxpayer to prove the contribution, so having good backup records will be important to claiming and benefiting from this state deduction.

Basis of Gifts – Basis is the term for the value of an asset; it is used to determine the profit when an asset is sold. The basis of a gift is the same for the giver and the recipient, but this amount is not used for gift-tax purposes; instead, the fair market value is used.

This is only an overview of the tax law regarding gifts and estates; please call this office for further details or to get advice for your specific situation.

Thank you for selecting our firm for your tax and accounting needs. We appreciate the confidence you have shown in us, and we remain ready to assist you at any time.

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