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Tax & Business Alert

FEBRUARY 2016

# GOOD EATS, TAX BREAKS: DEDUCTING EMPLOYEE MEAL COSTS

One thing about *human* resources — they need to eat. Just about every employer encounters situations in which it needs to provide meals to its employees. No matter how often you do so, be sure you're aware of the tax rules for deducting these costs.

## CLAIM HALF OR ALL

Generally, a business may deduct only 50% of the cost of business meals for federal tax purposes. But food provided to employees may be fully deductible in circumstances such as when meals:

- Are provided as additional compensation (and thus included in employees' taxable income), or
- Qualify as tax-free de minimis fringe benefits.

You may also write off food, and exclude it from employees' income, if it's furnished for your convenience and on your premises.

## FURNISH WITH A PURPOSE

Under IRS regulations, the "convenience of the employer test" is met only if meals are furnished for a "substantial noncompensatory business purpose." Although whether meals pass this test depends on the facts and circumstances of each case, the IRS has given examples of a number of acceptable circumstances.

For instance, food provided to keep employees available for emergency calls during the meal period generally qualifies for the full deduction. But such calls must actually occur or be reasonably expected to occur.

Another example is when the nature of the employer's business tends to shorten a meal to, say, 30 to 45 minutes. The furnishing of meals, however, isn't considered to be for a substantial noncompensatory business purpose if a meal period is shortened in order to allow employees to leave early.

A third instance is when employees cannot otherwise secure proper meals within a reasonable period. The regulations state that meals are fully deductible under this test if there aren't enough eateries near the workplace.

**Important note:** Under the current tax rules, if more than 50% of the employees fed on premises

### CONSIDERING A CAFETERIA?

Years ago, only the largest companies had on-site cafeterias. But some midsize businesses are now establishing them, too. There are a number of potential advantages to doing so. Keeping employees on your premises can cut down on excessively long lunch breaks and foster collaboration among team members. A good cafeteria could also attract better job candidates.

From a tax perspective, an employer-operated eating facility is usually considered a de minimis fringe benefit. So the costs of providing meals there are generally 100% deductible as long as the cafeteria is located on or near your premises.

But there are a number of complex rules involved. For instance, the eating facility's revenue must normally equal or exceed its direct operating costs. We would be glad to work with you to ensure that the facility qualifies for tax-advantaged treatment when established and on an annual basis.

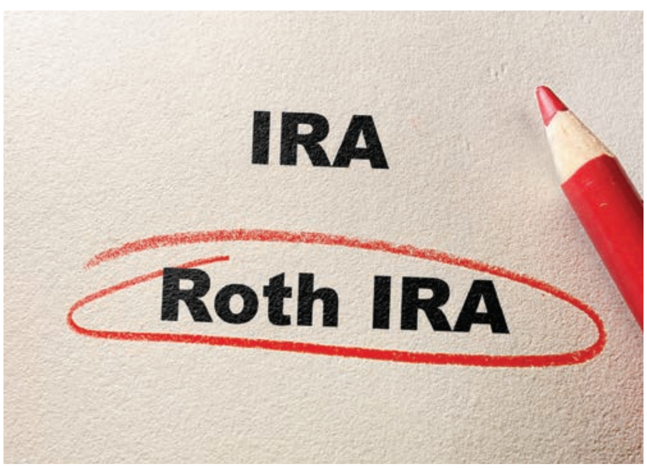
are furnished meals for the employer's convenience, then *all* meals furnished on premises are treated as furnished for the employer's convenience. Therefore, these meals are excludable from employees' income, regardless of whether every employee meets the convenience test.

### ENJOY YOUR MEALS

From a tax perspective, providing meals to employees can be deceptively simple. On their face, the rules seem straightforward, but many exceptions and caveats apply. Stay apprised of the latest IRS guidance and double-check your company's meal deductions every year. ■

## REACQUAINTING YOURSELF WITH THE ROTH IRA

If you've looked into retirement planning, you've probably heard about the Roth IRA. Maybe in the past you decided against one of these arrangements, or perhaps you just decided to sleep on it. Whatever the case may be, now's a good time to reacquaint yourself with the Roth IRA and its potential benefits, because you have until April 18, 2016, to make a *2015* Roth IRA contribution.




### FREE WITHDRAWALS

With a Roth IRA, you give up the deductibility of contributions for the freedom to make tax-free qualified withdrawals. This differs from a traditional IRA, where contributions may be deductible and earnings grow on a tax-deferred basis, but withdrawals (less any prorated nondeductible contributions) are subject to ordinary income taxes — plus a 10% penalty if you're under age 59½ at the time of the distribution.

With a Roth IRA, you can withdraw your contributions tax-free and penalty-free anytime. Withdrawals of account earnings (considered made only after all your contributions are withdrawn) are tax-free if you make them after you've had the Roth IRA for five years and you're age 59½ or older. Earnings withdrawn before this time are subject to ordinary income taxes, as well as a 10% penalty (with certain exceptions) if withdrawn before you are age 59½.

On the plus side, you can leave funds in your Roth IRA as long as you want. This differs from the required minimum distributions starting after age 70½ for traditional IRAs.

### LIMITED CONTRIBUTIONS

For 2016, the annual Roth IRA contribution limit is $5,500 ($6,500 for taxpayers age 50 or older), reduced by any contributions made to traditional IRAs. Your modified adjusted gross income (MAGI) may also affect your ability to contribute, however.

In 2016, the contribution limit phases out for married couples filing jointly with MAGIs between $184,000 and $194,000. The 2016 phaseout range for single and head-of-household filers is $117,000 to $132,000.

### CONVERSION QUESTION

Regardless of MAGI, anyone may convert a traditional IRA into a Roth to turn future tax-*deferred* potential growth into tax-*free* potential growth. From an income tax perspective, whether a conversion makes sense depends on whether you're better off paying tax now or later.

When you do a Roth conversion, you have to pay taxes on the amount you convert. So if you expect your tax rate to be higher in retirement than it is now, converting to a Roth may be advantageous — provided you can afford to pay the tax using funds from outside an IRA. If you expect your tax rate to be lower in retirement, however, it may make more sense to leave your savings in a traditional IRA or employer-sponsored plan.

### RETIREMENT RADAR

Roth IRAs have become a fundamental part of retirement planning. Even if you're not ready for one just yet, be sure to keep the idea of opening one on your radar. ■

## WHY FLIP REAL ESTATE WHEN YOU CAN EXCHANGE IT?

There's no shortage of television shows addressing real estate these days. Many of these programs emphasize "flipping" properties when an adequate gain has been reached. But, if you're ready to move one of your investments, you might prefer to *exchange* it rather than flip it.

### REVIEWING THE CONCEPT

Section 1031 of the Internal Revenue Code allows you to defer gains on real or personal property used in a business or held for investment if, instead of selling it, you exchange it solely for property of a "like kind." In fact, these arrangements are often referred to as "like-kind exchanges." Thus, the tax benefit of an exchange is that you defer tax and, thereby, have use of the tax savings until you sell the replacement property.

Personal property must be of the same asset or product class. But virtually any type of real estate will qualify as long as it's business or investment property. So if you wish to exchange your personal residence (including a vacation home), you'll have to first convert it into an investment property.

### EXECUTING THE DEAL

Although an exchange may sound quick and easy, it's relatively rare for two investors to simply swap properties. You'll likely have to execute a "deferred" exchange, in which you engage a qualified intermediary (QI) for assistance.

When you sell your property (the relinquished property), the net proceeds go directly to the QI, who then uses them to buy replacement property. To qualify for tax-deferred exchange treatment, you generally must identify replacement property within 45 days after you transfer the relinquished property and complete the purchase within 180 days after the initial transfer.

An alternate approach is a "reverse" exchange. Here, an exchange accommodation titleholder (EAT) acquires title to the replacement property before you sell the relinquished property. You can defer capital gains by identifying one or more properties to exchange within 45 days after the EAT receives the replacement property and, typically, completing the transaction within 180 days.

### PROCEEDING CAREFULLY

The rules for like-kind exchanges are complex, so these arrangements present many risks. If, say, you exchange the wrong kind of property or acquire cash or other non-like-kind property in a deal, you may still end up incurring a sizable tax hit. Be sure to call us when exploring a Sec. 1031 exchange and particularly before executing any documents. ■

## MARRIED FILERS, THE CHOICE IS YOURS

Some married couples assume they have to file their tax returns jointly. Others may know they have a choice but not want to rock the boat by filing separately. The truth is that there's no harm in at least considering your options every year.

Granted, married taxpayers who file jointly can take advantage of certain credits not available to separate filers. They're also more likely to be able to make deductible IRA contributions and less likely to be subject to the alternative minimum tax.

But there are circumstances under which filing separately may be a good idea. For example, filing separately can save tax when one spouse's income is much higher than the other's, and the spouse with lower income has miscellaneous itemized deductions exceeding 2% of his or her adjusted gross income (AGI) or medical expenses exceeding 10% of his or her AGI — but jointly the couple's expenses wouldn't exceed the applicable floor for their joint AGI.

However, in community property states, income and expenses generally must be split equally unless they're attributable to separate funds.

Many factors play into the joint vs. separate filing decision. If you're interested in learning more, please give us a call. ■

**EXECUTIVE MEMORANDUM**
**"WHY EXTENSIONS ARE GOOD!"**
**BY GARY SELLARI, CPA/PFS, MSM**
**UPDATED JANUARY 2016**

When I first started working for the Firm of Divine & Blalock in the early 1970s, only about 15% of the Firm's income tax returns were filed under extension. That was at a time prior to the introduction of Internal Revenue Code Section 444, which virtually eliminated fiscal year-ends for most flow-through business entities and Trusts. As a result of Code Section 444, the tax profession "lost" some planning techniques and strategies. The profession also lost some of its ability to spread out its workload. When Internal Revenue Code Section 444 went into effect, workload compression for the tax preparation industry went up - especially for CPA firms, which generally deal with the more complex business, entities and individual issues.

Workload compression for the Internal Revenue Service also increased with the introduction of Code Section 444 because of its need to deal with literally millions of additional calendar-year entities that, at one time, would have been fiscal year-ends. Also, the rate of tax law change, which has always been high, still continues to increase. Recent years' changes (including 2014 and 2015 changes made just before the Christmases, which were mostly retroactive to the beginning of 2014 and 2015, respectively) have gotten worse than ever. The pressure on the IRS to create, distribute and be ready to accept new and changed Forms, the need to change significant amounts of source Code by tax software companies and the need for tax professionals (inside the IRS and outside) to "absorb" all the changes, for simple and more complex matters, only further exacerbates the work period compression problems. In response to such type pressures, **I have been "pressing" for the increased use of extensions, for our Firm's clients, for years**. Also, the IRS remains receptive (and even desirous) that taxpayers use extensions.

The standard federal extension forms of today automatically extend the filing due date to October 17 (for 2015 returns) for Forms 1040 and to September 15 for most calendar-year Trusts, Partnerships and S and C Corporations.

The IRS has made obtaining an extension easy. Today's federal "automatic extension" form does not even ask for a signature – just an estimate of the amount due. The taxpayer(s) no longer even needs to pay the estimated tax due in order to get the extension. The current extension forms (which are now normally "e-filed") basically just ask, "How much do you think you will owe?" and, separately, "How much are you paying?" A timely-filed extension is still valid, even if no estimated tax due payment is made. The taxpayer may have to pay interest and an underpayment penalty on any underpayment amount, but the large, late-filing penalties will not be applicable. The extension is valid. Again, these rules reflect IRS attempts to ease the extension process from their end.

Federal tax extensions are generally advisable for numerous tactical reasons that extend well beyond workload compression issues. Based on past and more current discussions with numerous tax professionals (both within and outside our Firm), coupled with my own experiences, despite the "file early" in order to file before an identity crook files using your name etc. logic, I continually come to the conclusion that, with very few exceptions, there simply are no adverse consequences or exposures involved in using an extension. In fact, quite to the contrary, **there are numerous potential benefits that can be obtained by getting a Federal (and where applicable, a State(s)) tax filing extension. Such potential benefits include**:

1. Filing returns beyond the sometimes rushed "crunch time" constraints of "Tax Season" **decreases** the **possibility of error** and/or the overlooking of a planning opportunity(s).

2. Often times, **amended** or initial, extended business returns, **K-1s**, 1099s, etc., are received after the initial filing due date. **The chance of IRS audit is definitely lessened** by using the final correct amounts, as the IRS computer-matching mechanisms will be far less likely to "flag" an inconsistency. The reporting details that must accompany the tax reporting schedules from financial institutions on security sales continue to increase. The IRS continues to try to "push" more and more of their work and the details for "computer verify" onto tax preparers, via added reporting requirements on the actual returns and increasing e-filing requirements.

3. We do not like to complete a personal return prior to all of that return's related entity's returns being completed, in order to **make sure there is "consistency" amongst the various returns.** Tax position decisions are sometimes changed, based upon subsequently found facts, circumstances or later realizations. Our **ability to "change our minds"** is compromised, at best, if a return has already been filed. Filing all related returns, using a coordinated overall perspective, significantly increases our ability to defend tax return positions taken, if an IRS audit thereon later arises. Extensions definitely help make that result more possible.

4. Numerous commentators annually state their belief that filing an extension **lowers one's exposure to IRS audit** because of how the IRS processes, organizes and ranks returns for review and/or possible audit. (There is no official way to confirm this, but it is a widely-held belief in the professional tax preparation industry.)

5. There have been numerous instances in the past where tax law, Court cases, Regulation or Congressional legislative actions have **changed tax law**, with potentially retroactive application. More often than not, such later developments have been favorable to taxpayers.

6. If one does get an extension, it is true that might delay a refund. However, in general, refunds arise from overpaying one's taxes. From a tax-planning perspective, **our goal is not to get refunds – it is to minimize our clients' overall taxes**.

7. The only specific election I can think of, which could be adversely affected by getting an extension, is the election to take a tax deduction for a casualty loss in the year prior to the tax year the loss actually occurred. That election must be made by the related return's initial due date. (Note – there could be limited application to the "trader" election, but that election can be made by the necessary April 18 (this year) deadline, separate from an extended tax return.)

8. **Extensions often provide more time to make tax-deductible retirement plan contributions**. Such contributions are generally still deductible if made by the due date of the related return, including extensions.

9. Whenever a "flow-through" entity return is filed by the initial due date, an extension of the personal return **can actually shorten the statute of limitations' audit exposure period.** That is because the IRS generally only has three years to audit. For example, if a flow-through entity return is filed by March 15, 2016, but the related personal return is not submitted until the following October 18, 2016, the IRS only has until March 15, 2018 to audit the entity return so as to change the personal return. Thus, the personal (1040) return exposure period was reduced, as a practical matter, at least as to that entity's relevance, from October 15, 2018 to only March 15, 2018. Sometimes that can be a potentially helpful/useful strategy.

10. If an IRA was rolled over to a **Roth IRA**, the Roth IRA can be re-characterized back to a traditional IRA by the due date of that year's return, including extensions. Thus, an extension provides **added "hindsight"** ability to the **"re-characterize or not"** decision.

11. One major reason to extend, which often results in significant benefit by filing later in the following tax year, is the sometimes very useful **perspective gained by having more hindsight and more perspective on the current year** to make tax return preparation decisions for the prior year. Decisions such as – "Should I capitalize now or write-off?" "Should a particular payment be classified as a loan, distribution, reimbursement or other?" "Should a certain election be made or not that affects more than one year?" "Should a carry-back be used or instead be saved for carry-forward purposes?" etc., etc. The ability to have an increased **"hindsight/current year perspective window"** can only be obtained by using extensions.

Our Firm continues to file well over half of our clients' returns using extensions. **Purely from a tax-planning, client-oriented, consultative perspective, I would like to see us use extensions for even more of our returns, other than the very simplest ones**. I regularly encourage the use of an extension, even when a return has otherwise been completed. We want to take as much advantage as possible of the above-listed, client-oriented, potential benefits. Of course, we realize that many clients, for various reasons, do not want to extend. We try to accommodate them – sometimes even despite our belief that such may not be in that client's ultimate best interest.

(Note – many States are not as "accommodating or lenient" with their extension rules and procedures as the IRS. Special care may be needed for clients with State tax return filing obligations.)

We continually strive to meet, and more often than not achieve, our Firm's stated goal – *"To make or save for you far more than you invest in us."*

GBS:mgb/jbr
January 25, 2016