

Tax Tidbits

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Most organizations have rules and consequences for tardiness and the Internal Revenue Service is one such organization. Section 6000 of the Internal Revenue code covers tax return requirements and penalties enforced by the Service. Interest on late payments is covered by section 6601. The charge of interest is incurred when tax is not paid on time. It is figured from the due date of the tax until the date that the tax is paid in full. Unlike most penalties, interest cannot be waived, as it is the “time value of money.” Interest rates change on a quarterly basis. The current rate of interest for underpayments is 3 percent.



It must be remembered that, as a taxpayer, you are required to make payments throughout the year. Payments can be made by having taxes withheld from payments received – wages, commissions, retirement distributions, etc. Estimated tax payments can be made quarterly throughout the year. Businesses with employees are usually required to make Federal Tax Deposits for employment taxes. IRC Section 6651(d) covers late paying penalties. Initially, the penalty is the first ½% of the unpaid tax for each month or part of a month the tax is not paid. If the Service issues a “Notice of Intent to Levy” and the balance due is not paid within 10 days from the date of the notice, the penalty increases to 1% per month. The penalty cannot be more than 25% of the tax paid late.

Filing and paying late is covered under the broader cover of IRC Section 6651. The Service charges a penalty of 4 ½% for filing late and ½% for paying late. The combined penalty is 5% of the unpaid tax for each month or part of a month the return is late, but not more than 5 months, which would total 25% (22 ½% late filing and 2 ½% late paying).

In addition to the 22 ½% late filing penalty for the first 5 months, the Service continues to charge the ½% late paying penalty for each month or part of a month for as long as the tax is unpaid, but not for more than 25%. The maximum penalty that the Service can charge is 47 ½% (22 ½% late filing penalty plus 25% late paying penalty). If the Service catches up with a taxpayer first and assesses a tax on unreported income in excess of \$5,000, it can assess an “accuracy-related” penalty under IRC section 6662 of 20% of the tax on unreported income. If fraud is suspected, the penalty rate jumps to 75% under IRC section 6663(b).

It is very difficult for most law abiding taxpayers to even imagine incurring penalties, like those described above, much less experiencing them. Unfortunately, life happens and money stops flowing, bills stop getting paid and tax returns do not get filed. If you or someone you know has fallen into this type of situation, do not think that this will go away. Act now! Call us, the tax professionals, to let us help you or the person for whom you care.

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“Too bad that all the people who know how to run the country are busy driving taxicabs and cutting hair” – George Burns

Child Tax Credit Decrease Proposed

Unless you are subject to the income limits affecting the child tax credit, you are receiving a \$1,000 credit for each qualifying child. Remember, tax credits are direct dollar for dollar offsets to your income tax liability. Starting in 2013, the maximum credit will drop to \$500 per qualifying child. The larger your family, the more this credit reduction will impact your family's taxes.

Giving in 2013 vs 2012

With the prospect of the income tax rates increasing in 2013, in order to optimize the tax benefits from charitable giving, a taxpayer must weigh whether it makes sense to give in 2012 vs 2013 or to defer some of the giving to 2013, since the charitable contribution may be worth more in 2013. A careful analysis should be done with your tax advisor to determine the costs and benefits to giving more in 2012 vs 2013. Additionally, choosing to wait for 2013 to make charitable gifts, you should consider making a gift with appreciated long-term assets rather than cash.

This tactic deserves a second look in light of rising tax rates. There are double benefits when giving appreciated assets – first, when gifting appreciated assets to charity, you avoid being taxed capital gains tax on the stock and second, a gift to a qualifying charity provides an income tax deduction amounting to the appreciated value of the stock, not the original stock cost. There are certain limitations to charitable contributions based on level of income. It is important to remember, charitable contributions are not AMT tax preference items.

New Medicare Tax

Commencing in 2013, your investment income could be subject to a new tax. If you are a married filing jointly taxpayer with income over \$250,000 or a single taxpayer with income over \$200,000, you will be subject to a new Medicare Tax. If you meet those income and status criteria, a 3.8% tax will be applied to

some or all of your investment income, including capital gains. This will be in addition to ordinary income or capital gains taxes that you may already be paying. The 2010 Reconciliation Act imposes this tax.

The Worth of Capital Losses

With the prospect of capital gains tax rates climbing from 15% to 20%, investors might wonder how much their capital loss carry forward or what the unrealized losses in their portfolio might be worth. One of the tax savings strategies that many taxpayers use at year end is to realize capital gains. Remember that capital losses not only offset capital gains, but they also offset up to \$3,000 of ordinary income, beyond capital gain income. Timing becomes key in optimizing this ploy, especially not knowing how this will play out in Congress. If the capital gains rates do, in fact increase in 2013, then the losses become more valuable to offset gains taxed at 20% as opposed to using them to offset gains taxed at 15%. You will need to work closely with your investment advisor and your tax advisor to sort all this out. If you have your investments with us, your investment and tax advisors are “under one roof”. If you have any concerns about this, please give us a call.

Possible Rate Changes

At the end of 2012, significant provisions of the landmark Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) are set to “sunset” or expire. At the end of 2010, Congress voted to extend most of the affected tax provisions. The question is, will Congress extend the provisions again? If Congress decides not to affect an extension of the “Bush” tax provisions, we can expect to see tax rates increase in three areas. The first area of tax increases will be in income taxes. First of all, the 10% tax bracket will disappear and the other brackets will increase. The 15% tax bracket will start at \$0 and top out at about \$35,000 for single filers and about \$59,000 for joint filers. The next bracket will jump to 28% starting at the \$35,000/\$59,000 for single/joint, respectively.

The upper limit of the 28% would be approximately \$85,000 for single filers and \$143,000 for joint filers. Most Americans are in these income ranges, consequently, they will be experiencing quite a “tax shock”. The next 3 tax brackets jump from 28% to 31%, 33% to 36%, and 35% to 39.6%. As for long-term capital gains taxes, if Congress does not extend favorable capital gains tax rates in 2012, beginning in 2013 taxpayers in the 15% ordinary tax bracket will no longer be able to avoid paying long-term capital gain taxes. Taxpayers in higher tax brackets will experience a rate increase from 15% to 20%. Lastly, the attractive current long-term capital gains rates through 2012 apply to qualified dividends. In 2013 qualified dividends will be taxed at ordinary income tax rates. As a result of these tax law changes, investors will probably be closely examining their dividends and dividend paying stocks housed in their investment portfolios.

Identity Theft Revisited

As you have seen in the news within the last several months fraudulently filed tax returns were occurring at an all time high. Certain urban areas were experiencing this more than other parts of the country. Criminals have transitioned their focus to stealing money from the government in the form of filing fraudulent tax returns instead of other forms of crime, as “it is safer and easier.”

In the May 2009 issue of Tax Tidbits, we wrote an article about identity theft as it related to social security number theft and the exposure that it brings to an individual when a social security number has been stolen. Be alert to possible identity theft if you received an IRS notice or letter that states that:

- *More than one tax return was filed for you
- *You have a balance due, refund offset or you have had collection actions taken against you for a year you did not file a tax return or
- *IRS records indicate that you received wages from an employer unknown to you.

If you receive a notice from the IRS, take immediate action. Contact us and we can offer assistance in contacting the IRS on your behalf. With a power of attorney in effect, we can

complete and file for you the IRS Identity Theft Affidavit, form 14039.

You can minimize your chances of becoming a victim by:

1. Not carrying your social security card or any document with your SSN on it.
2. Not giving a business your SSN just because you are asked. Give it only when required.
3. Protecting your financial information. Shred all documents that contain your personal information.
4. Checking your credit report every 12 months.
5. Not giving personal information over the phone, through the mail or on the internet unless you have initiated the contact or you are sure you know with whom you are dealing.
6. Protecting your personal computer by using firewalls, anti-spam/virus software, updating security patches and changing passwords for internet accounts.

Please remember that the IRS does not initiate contact with taxpayers by email to request personal or financial information.

Be Prepared

Every year as we taxpayers prepare for the annual “ritual” of filing our tax returns, a certain amount of data gathering must take place. The obvious documents that need to be brought to your tax preparer are those that you received from third parties - i.e. W-2 forms, 1099 forms for interest, dividends and stock transactions. The next set of documents needed are those that support your deductions taken against income such as paid receipts for prescriptions, doctor bills, dentist bills, hospital bills, medical insurance, long-term care insurance to name a few. Miles driven from home to a medical facility, to a doctor’s office, even trips to the drug store to pick up prescriptions are deductible at 23 cents per mile.

Tax expenses are next on the list of tax deductions. Income taxes paid in the year are deductible in the year paid, even if the taxes relate to a prior year. Sometimes we have clients that have filed a state return late and have paid late (i.e. the subsequent year) and have taken the tax paid as a deduction in the following year. Additionally, state taxes withheld from wages are deductible, as well as state estimated income taxes. Sales taxes are deductible, but only if they

exceed income taxes. A taxpayer can use the tables to determine his/her sales tax amount (based on level of income) or use actual amounts of sales tax paid based on paid invoices. In either case, you can add to the sales tax deduction amount sales tax paid for large ticket items. These can include purchases of a car, a boat and even an airplane. In certain states, a personal property tax is assessed on items such as cars and equipment for businesses. In all these cases, the taxpayer needs to have his/her paid receipts and invoices to prove the amount used in the deduction. Charitable contributions are especially earmarked for examination. No deduction is allowed for cash or check contributions unless the donor maintains a bank record or a written communication from the donee showing the name of the organization, the contribution dates and the contribution amounts. For non-cash contributions, the gift needs to be well documented with lists of the items given with a sign off from the organization. Miscellaneous deductions cover a myriad of items such as tax preparation fees, unreimbursed employee business expenses, such as job travel, union dues and job education that can be written off. Most expenses that relate to investments are deductible in this category. These would be investment management fees, safe deposit box fees and legal fees that relate to tax planning or investment planning.

Audit News

In 2011, the overall audit rate was one out of every 90 tax returns. Taxpayers with incomes under \$200,000 experienced audit rates of 1.02%, which was down from 1.04% in 2010. Taxpayers with incomes of at least \$200,000, but less than \$1 million endured audit rates of almost 4%. The most audit pressure fell on taxpayers with incomes of \$1 million or more. Approximately 12.5% of taxpayers in this category were subject to scrutiny.

Standard Mileage Rates

The standard mileage rate for business driving is 55.5 cents per mile. The allowance is 23 cents per mile for medical purposes and job-related moves. There were 2 prior years where midyear increases took place after gas price spikes in the first half of the year 2008 and 2011. The standard mileage rates were raised materially by Congress those years. There is some indication that the price at the pump could keep rising throughout spring. Could the price of gas rise enough to trigger another adjustment? If so, it is usually by July 1st, like it was last year.

Help Us Help Someone You Know...

We work hard to assure the satisfaction of our clients. We would appreciate your referral of friends and family to us, so that we may deliver the same level of service to them that we provide to you.



Our location at 350 West Church Street, the northwest corner of West Church and Columbia Streets has become familiar to our clients. With adequate parking in the back, it is convenient to meet with one of our tax specialists to discuss tax questions and solutions.

This document was not intended or written to be used and it cannot be used for the purpose of avoiding tax penalties that may be imposed on the taxpayer.

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