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KEY MAN LIFE INSURANCE - TAXABLE?

Generally life insurance proceeds received by a corporation are not taxable. However, as we have noted in the past, under a provision in the Pension Protection Act, life insurance death benefits of employer-owned policies, issued after August 17, 2006, are taxable (to the extent the death benefit exceeds the employer's premiums) unless certain requirements are met.

In order to avoid taxation of these proceeds certain notice and consent requirements must be met. The employee must be notified in writing prior to the issuance of the policy that the employer intends to purchase life insurance on the employee's life and the maximum amount that will be applied for. The employee, then, must consent in writing to the fact that the employer might keep the policy in force, even if the employee leaves, and furthermore, that the employer is intending to keep the death benefit.

Once the notice and consent requirements are met, there are two exceptions to the rule taxing death proceeds payable to the employer. First, one of the following must be met:

- The insured was an employee at any time during the 12 month period before the insured's death, or
- The insured was a Director or highly compensated employee at the time the contract was issued.
- The insurance proceeds are being paid to a family member of the insured, a trust for the benefit of a family member, or a designated beneficiary other than the employer.

Secondly, there are also annual reporting requirements the employer must meet.

Again, these are not recent changes in the tax law, but disclosures that we believe employers should be aware. If you want assistance in implementing this issue, do not hesitate to contact us.

SAME SEX MARRIAGE - OHIO TAX CONSEQUENCES

In a previous issue of *Partners*, we discussed the federal tax consequences of same sex marriage. At that time, Ohio had not determined their position with regard to such unions. In a recent Information Release, the Department of Taxation issued guidelines for individuals filing a joint federal income return with someone of the same gender.

As the release notes, under the Ohio Constitution, marriage between persons of the same gender are not recognized. Individuals who entered into such a marriage, in another jurisdiction, are not permitted to use the filing status of married filing jointly or married filing separately when filing an Ohio income tax return. Instead, each person must file an Ohio return with the following guidelines:

- File a separate Ohio income tax return and check the box noting schedule IT-S is attached.
- Use the filing status single or head of household, if qualified.
- Complete schedule IT-S in which the individuals on the federal return allocate income between them and then file separate Ohio returns.

The State of Ohio has responded to this specific issue. We will have to see what other complications the nonrecognition of same sex marriage has for Ohio laws.

FREQUENTLY ASKED QUESTIONS:

What is the tax rate on capital gains and dividends?

A simple question, but not a simple answer.

Before the American Tax Relief Act of 2012 (don't you love the names of these acts?), the maximum tax rate on net capital gains and qualified dividends was 15 percent for taxpayers in the 25, 28, 33 or 35 percent individual income tax brackets.

Under ATRA, the 15 percent rate on net capital gains and qualified dividends is made permanent for taxpayers in the 25, 28, 33, or 35 percent individual income tax brackets. This treatment applies for 2013 and subsequent years. ATRA also makes permanent the zero percent tax rate on net capital gains and qualified dividends for individuals in the 10 and 15 percent income tax brackets.

In addition ATRA created a 20 percent tax rate on net qualified capital gains and qualified dividends intended to apply to higher income taxpayers. The 20 percent tax rate applies to qualified capital gains and qualified dividends of taxpayers subject to the 39.6 percent income tax bracket. These persons are subject to the 39.6 percent income tax bracket to the extent their taxable income exceeds certain thresholds; $450,000 for married couples filing joint returns and surviving spouse, $425,000 for head of households, $400,000 for single filers, and $225,000 for married couples filing separate returns.

For gains related to the sales of collectibles or certain depreciation recapture, the rates have not been changed by ATRA. These sales are taxed at a 28 percent rate for collectibles and 25 percent rate for certain depreciation recapture amounts.

Furthermore under the Affordable Care Act, there is imposed a 3.8 percent surtax on individuals, estates and trusts that have certain investment income (which generally includes dividends and capital gains unless related to a trade or business) with threshold amounts of $250,000 for married couples filing jointly, and $200,000 for single filers.

A complicated answer, to what appears to be a simple question. It is a result of tax "simplification". We would be pleased to review the impact of these rates upon your personal situation. Do not hesitate to contact us.

Hobby or Business? Does It Matter?

You may be among millions of Americans who have hobbies such as sewing, photography, woodworking, fishing, gardening, and collecting. When that hobby begins to become profitable, the IRS may deem it to be a taxable business.

The Tax Code defines a hobby as an activity that is not pursued for profit. A business is an activity that exists with the reasonable expectation of earning a profit.

Whether your activity is a hobby or a business, the income is potentially taxable. However, when it comes to deductions against that income and losses related to it, the two activities differ in their tax implications.

Subjective factors to consider in determining whether you have a business or a hobby include:

- does the time and effort you put into the activity indicate an intention to make a profit?
- do you depend on income from the activity?
- do you have the knowledge needed to make the activity successful?
- does the activity make a profit in some years?
- do you expect to make a profit in the future from the activity?

An activity is presumed to be for profit if it makes a profit in at least three of the last five tax years (or two of the last seven years for activities that consist primarily of breeding, showing, training, or racing horses). Not meeting this presumption, does not mean the activity is a hobby, it just requires additional support to overcome it.

The IRS position is that it looks at all facts and circumstances when determining whether a hobby is for pleasure or business, but the profit test is the primary one.

If the activity is determined to be a business, you can deduct ordinary and necessary expenses for the operation of the business. An ordinary expense is one that is common and accepted in your trade or business. A necessary expense is one that is appropriate for your business.

If an activity is deemed to be a hobby, not for profit, losses from the activity may not be used to offset other income. You can only deduct expenses up to the amount of income earned from the hobby. These expenses, with other miscellaneous expenses, are itemized expenses subject to a limitation of 2 percent of your adjusted gross income.

Still wondering whether your hobby is actually a business? Contact us and we will assist you in figuring it out.

RULES FOR AN INHERITED IRA

Generally, investors open an IRA with one goal in mind: To accumulate assets tax-deferred for retirement. However many of you may not need to access these funds for retirement. Therefore, ultimately, this investment may be passed to your beneficiaries upon your death. The taxation of this account varies depending upon who becomes your beneficiary.

For a spouse inheriting an IRA, taxation depends on whether the account owner has started taking distributions. If not, the spouse can treat the IRA as his or her own and roll it over to an IRA in his or her name. Bear in mind that if you roll the plan into your IRA, and are younger than age 59-1/2, any distributions you take will be subject to a 10% penalty for early withdrawal. If you leave the IRA account as a "beneficiary IRA", you can not only withdraw assets penalty free immediately, but you will have to receive Required Minimum Distributions (RMD) every year based on your own life expectancy.

If the owner had begun taking distributions before dying, another variable depends on the couple's ages when the account holder died. If he died after starting to receive RMDs, and was older than his wife, the wife can treat the IRA as her own. However, if the decedent dies after starting the distributions and was younger than his wife, she can treat the IRA as a spousal inherited IRA and take RMD based on the previous life expectancy of her deceased husband.

The rules for a non-spouse beneficiary are more advantageous, because you can extend the growth of an IRA investment. This is typically called a stretch IRA. A non-spouse beneficiary, who inherits the IRA before RMDs began, can take distributions based on his or her own life expectancy. If the beneficiary is a child or someone much younger, those distributions may be much smaller so more of the account value has the opportunity to grow tax-deferred over a longer timeframe. If he or she inherits the IRA after the account owner had begun minimum distributions, he or she can take distributions based on the longer of either his or her or the decedent's life expectancy.

Ultimately, the younger the beneficiary, the greater the growth opportunity over his or her longer life span.

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