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JIM: Have you compared your tax returns of this year from last year? Did you end up paying more? A lot of clients this year are surprised to find out that their actual tax bill was more. Don’t just look at your refund. Look at the actual amount of taxes owed on your 1040 compared to the year before. If you paid more, sit down with your professional team of advisors and find out what happened and what steps you can take in 2015 to avoid some of the new tax increases that are going to affect you. Joining us today is Larry Fortenberry, a CPA who has been counseling clients and advising them for over 30 years. He has been a guest in the past. He has a wealth of information and ideas that can help save you money on your taxes come 2015. Welcome, Larry.

00:53

LARRY: Good morning.

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JIM: Hey, it’s great to have you here. I think a lot of people this year might be a little bit surprised when they do their returns because there’ve been a lot of changes in some of the tax regulations. I heard you speak a couple years ago. You’re one of the people that has probably the most thorough understanding of the tax forms including the 1040s, the W-2’s, the 1099s and not only a clear understanding but a great way of being able to transfer that knowledge to laymen like myself. What I thought I’d do is I think a lot of people might be a little bit surprised because I think they’re going to end up paying a little bit more taxes this year because of some of the changes. Can you go over with our audience what some of those changes are and how they’re going to affect a lot of the middle class taxpayers that listen to our program.

01:38

LARRY: Sure, thanks, Jim. First of all, I’ll start off by telling you that the tax rules for 2014 were finally set in stone with two weeks remaining in the year. Basically, what that means is breaks that expired after 2013 were revived but this extension is only for 2014. An effort to extend it through 2015 while making several other permanent provisions fell apart after President Obama said he would veto the package. For 2014, these are some of the key tax breaks that were preserved; includes the itemized deduction for state sales tax in lieu of income tax, an above-the-line deduction for up to $250 of educator’s classroom supplies, also the exclusion for up to $2 million of forgiven debt on primary homes, and the ability of folks age 70-1/2 and older to make direct payouts up to $100,000 from IRAs to charity. Those were all preserved and those were the major things also along with bonus depreciation. Basically, if you were buying a vehicle, up to $60,000 of an SUV was subject to the Section 179 depreciation. Those were the major things that carried over from 2013. Once again, they were put in force only for 2014. The only thing that we know that will be different right now in 2015 is that a tax-deferred ABLE savings account for the disabled, similar to 529 plans, was put in place. Now what is this account? Starting in 2015, nondeductible pay-ins of up to $14,000 a year can be made to ABLEs for those who become blind or disabled before age 26 and payouts will be tax-free if used for housing, transportation, education, job training, and the like. That is a major provision for 2015. I verified with some of the fund families such as American Funds. At this point, they have not generated – American Funds at least has not generated – a product for the ABLE account similar to the 529 plan.

03:46

JIM: That must be something similar like we had the treasury ruling with CULAX for retirement accounts where people who are 70-1/2 can actually delay a payment on up to 25% or $125,000 on their retirement accounts. The last time I checked, there’re only two companies that have products that fit that criteria so I think it’s something we’re just going to have to wait for.

04:08

LARRY: That’s correct and I think it’s something to keep looking for because it could have great application for us helping our clients there.

04:15

JIM: Absolutely. Well, we talked about some of the things that were preserved and I must emphasize for those listening. You talked about the accelerated depreciation and some of these other things that are available for 2014. Well, we’re in 2015 so as Larry’s talking about it, if you did it already, you might be in luck but going forward, there’re some different rules so you’ve got to be careful. Right now, we’re focusing on a little bit about what’s happened that’s different in 2014. We’ll get into some things that are going to be different in 2015 but let’s talk about itemized deductions, Larry. I know a lot of my clients, there was a change in threshold and there’s a phase-in, something where it used to be 7.5%, now it’s got to be 10% of your adjusted gross. Can you expand on what that is and what that’s all about?

05:00

LARRY: Yeah, what you’re referring to there, Jim, is the itemized deduction for medical expenses. If you’re an individual under age 65, then to deduct any of your medical expenses, which includes hospital insurance, doctors, drugs, etc., if you’re under 65, the deduction is limited to any amount over 10% of your adjusted gross income if you’re under 65. If you’re 65 or older, then your medical deductions are limited to 7.5% of your adjusted gross income. If you have $10,000 worth of medical expenses, your adjusted gross income is $100,000, then 7.5% of your adjusted gross income is $7500; hence, your medical deduction would only be $2500 there.

05:46

JIM: That’s going to impact people because a lot of people that might have been accustomed to itemizing, medical is a big part of that. What are some of the other things that go into calculating the itemized deduction, Larry?

05:57

LARRY: Well, you have income taxes and if you live in a state that does not have income taxes for 2014, the ability to deduct state sales taxes was kept in the code, which is and/or you have the ability to deduct the higher of state sales taxes or state income taxes that you pay. You go by a formula. Each state has a formula dependent on the number of people in the family and I believe also if you have major or you can actually sit down and add up everything that you bought during the year and compute the sales tax on that. If it’s greater than the amount in the schedule, use that.

06:34

JIM: Did you say that’s going away for next year?

06:37

LARRY: It was left in for 2014. All bets are off for 2015. We don’t know yet.

06:43

JIM: Here’s where it’s really critical. Everybody’s getting their tax returns done and what happened in 2014 is already too late and I think a lot of people are going to be surprised on their tax return because they may not be aware of these changes and they’re going to be impacted if they’re used to getting those deductions. This is going to have a huge impact. There’re several states that have low or no income tax where the sales tax deduction has been a pretty big deal for them. You combine that with healthcare being probably one of the biggest itemized deductions for most families, especially as more of them are transitioning to higher and higher deductibles, they’re going to find more and more of those expenses are going to be using after-tax dollars for, another reason people should be sitting down with their advisors and looking at things like Health Savings Accounts and other ways of maybe reducing their taxes, whether it’s retirement funding and things like that because if you’ve been accustomed to huge itemized deductions and now all of a sudden, you’re defaulting to the standard deduction, it could have a big impact on your tax return. How about the phase-outs of deductions for higher earners. Have we had any changes on that?

07:48

LARRY: No, those rules remain in effect the same as they were for 2013. If you have income over a certain level, I think it’s basically over $150,000, then your itemized deductions and your personal exemptions could be limited and you go through a formula to determine that but yes, there is a possibility in 2014 that you could have your itemized deductions and personal exemptions limited due to your income. I mentioned one other thing. On the itemized deductions, what I’m finding too with my older clients, those older being people who are 65 or older, normally mortgage interest is one of your biggest deductions on your tax return. That’s what helps a lot of people be able to itemize but as your clients get older, most of them are paying off their mortgages so I’m noticing my 65 and older clients are the ones who are no longer being able to itemize, just to go back to your point about losing the itemization.

08:43

JIM: We’re going to take a short break and when we continue, we’re going to talk about what’s in store for people as they get their returns back as well as some planning tips for 2015 because there’re going to be more changes in 2015 and now is the time to look at it while you still can make changes that can impact your bottom line come next year. Please stay tuned.

[BREAK]

09:48

JIM: Welcome back as we continue to visit with Larry Fortenberry. He’s a CPA, CLU, ChFC, which means he’s very knowledgeable on this subject and Larry’s been doing financial planning for clients and tax planning for clients for several decades. I thought I would have him back. He’s a past guest and I know there’ve been a lot of changes that are going to impact people. One change, we had a guest on a while back that was a health insurance expert and he was talking about the April surprise. That comes in the area of ObamaCare. Now I know right now, there is a court ruling that’s going up to the Supreme Court right now where they’re basically throwing out ObamaCare is not following the law and the law that’s being affected right now is the subsidies that are available for people that was written into the law that if you’re in a state that does not create its own state exchange and my understanding is there’re something like 32 or 33 states, maybe 37, but the majority of the states did not set up their own healthcare exchanges and as a result, anybody who applies for an ObamaCare program is not eligible for the subsidies. Well, the federal government just said well, our intent was to provide these subsidies so we’re just going to provide it so stay tuned. There may be more coming on this but let’s assume that people continue to be eligible for those subsidies. This year, people pretty much were on the honor system. They just declared what their income was and if people fudged on that a little bit or let’s say they were unemployed and now found a job and their income spiked or they just got paid more because of a raise along the year, they kept going along with the subsidy from when they originally applied. Well, if all of a sudden they’re not eligible for as big of a subsidy, our courts have ruled that it’s a tax so through the tax returns is how they’re going to get back this subsidy money. Can you talk a little bit about what you might be seeing, Larry, as you’re preparing returns or what you might have heard about in the industry for tax preparers as people are maybe finding out that there’s a surprise there waiting for them.

11:48

LARRY: You’re absolutely correct. Most of the people that returns I do, all of them have health insurance but we are finding that it is on the honor system. There is a block on the second page of the tax return that you check if you’ve had coverage. If you have not had coverage for the full year, then there is a series of additional forms that go with the tax return that you have to complete or whoever’s preparing your return has to complete or if you don’t have health insurance and think that you meet an exception to it, there is a form you have to fill out for that to prove that you, in fact, are not required to have health insurance. There’re going to be two surprises to this. First of all, people who have been used to walking into storefront tax preparers, getting the return knocked out in an hour, and getting their refund are going to be surprised that possibly it’s going to take them longer than that to get their return done or either they’re not going to have the information they need to give to the preparer to do the return that day. What that’s going to create I think is higher tax preparer fees so you’ve got a double whammy here. It’s going to cost the people who needed the health insurance who got a subsidy to get it. It’s going to now cost them more to file their tax return and if they, in fact, got a subsidy that was greater than what their income warranted, then there will be a reduction in their refund. I think it is going to be an April surprise and plus too the Internal Revenue Service, it’s all on an honor system. With all the other problems that the IRS has nowadays, I only see this adding to their problem because there’s no way they can keep up with all of it.

13:19

JIM: My understanding is that this year it’s on the honor system but now with new reporting forms with employers having to report whether or not you have health insurance and you’re going to get a tax form that’s proof that you have insurance that’ll be going forward as you file the returns, I’ve got to believe that people might get away with something this year if they try to ignore it but it’s going to catch up with them because the IRS and the federal government are putting systems in place to be able to track this, similar to what they did with retirement accounts. I know a lot of clients just ignored the required minimum distribution rules and the IRS started requiring the companies where the IRAs were held to start reporting balances on IRAs on a 1099-R and if people didn’t take their withdrawals, they now had a way of tracking it. Well, they’re doing something similar on the health insurance from my understanding. Is that correct?

14:12

LARRY: That is correct. On the W-2’s, there is a block that indicates the amount of employer-paid health insurance premiums that everybody gets now. If you have health insurance, there will be a block indicating the cost of that. Now that’s not taxable to you yet but it is reported on the W-2, the cost of the health insurance.

14:30

JIM: The other thing that I look at, the Supreme Court ruled that this is a tax. If this is a tax, if people got back more in subsidies than they should have, then that’s going to be a tax owed and I know the guest we’ve had on before wasn’t certain if that would fall under the same rules that if there was underpayment or they received more of a refund than they should have, will this be subject to underpayment penalties or late filing fees or late payments and then will that accrue an interest as well with interest and penalties? Have you heard anything about that yet, Larry?

15:04

LARRY: I have not definitively. I think I heard in the early stages that it would not be considered that, once again, trying to make it a tax but not make it a tax, if that makes sense but no, I have not seen anything definitive on that and once again, I think that part of this problem is too enforcing all of this and the IRS having the manpower to do it.

15:25

JIM: It’s going to be interesting. I keep hearing that this was supposed to save us money and now I look at some of the ancillary things like some people that are getting subsidies shouldn’t be. Will they have to pay that back and then the additional cost of getting the returns done and now we have itemized deductions for healthcare have been reduced. I’m not seeing a lot of people saving from this bill but hopefully more people are covered and hopefully they’ll work this out and it’ll be a good system for all or at least maybe they can fix it and make it better than we’ve had before but boy, I see a lot of challenges ahead.

15:57

LARRY: Let me elaborate on that too. If you’re eligible for a premium tax credit, you have to file Form 8962 and if you had an advance payment, you have filed that same form to see if you were paid too much so 8962 is the form that you file to verify that.

16:15

JIM: Alright, well, Larry, we talked about all the challenges and people might be owing more. In 2015, we have some more changes coming down the pike. What are you advising your clients or what strategies are you implementing for 2015 so come next year the bite isn’t quite as steep? What are you recommending?

16:33

LARRY: I’ll tell you something that I looked at, especially for your high income individuals who may be subject to this additional investment income tax. I know we’ve talked before in the past about looking at what you have on your Schedule B, which is your interest income, your dividend income, and also looking at your Schedule D, which are your capital gains and losses. We looked at that in regard to maybe taking some of that income off of your tax return to hopefully lower the amount of your social security that would be taxable because if we put money into fixed annuities and/or variable annuities, then we are taking that income off the tax return, which is not a factor maybe in computing how much social security you would have to pay tax on. I did a little research and I think that part of investment income is annuities but they seem to be annuities that you are getting paid such as if you’ve got a SPIA and you’re receiving an annual income from that SPIA, then the taxable portion of it is included in investment income but nothing I can see and in verifying with other CPAs, if I move that money out of a CD into a single-premium deferred annuity or if I move some of my mutual funds into a variable annuity, I believe now I take that income off of the tax return and take it out of the calculation for this investment income tax. That’s one thing I would tell people to look at and that would be the major thing if I had high income individuals there.

18:09

JIM: What about if people are losing their itemized deductions? Are there some other strategies, Larry, that you see to help reduce their tax burden?

18:16

LARRY: As we talked about there, a lot of people overlook the fact that they can still contribute to an IRA. A lot of people even though overlook the fact that due to their income, even though they’re covered by a pension plan, they can put money in a Roth IRA. Now while we know the contribution to the Roth is not taxable, depending on your age, the accumulation tax-free and being able to take it out tax-free may be better than the current deduction. Those are the kinds of things I would look at.

18:43

JIM: I think the moral of the story is these rules change. Get ahead of the curve. Sit down with your financial advisor, sit down with your insurance professional, sit down with your CPA, and ideally sit down with all of them together and say okay, here was my tax bill in 2014. I got a little bit surprise of how much I owed. What am I missing? When you look at deductions, you talk, Larry, about the IRA deduction. It’s not been since yesterday that I sat down with somebody and they didn’t realize they could do deductible IRAs. They didn’t realize that they could do Roth IRAs. They thought they just made too much money but what happened is the husband’s employer suspended any contributions to a retirement plan. They used to have a SIMPLE IRA. No contributions were being made. Now even though his wife had a 403(b), he was eligible to either do a Roth or a traditional and get the full deduction if he did traditional. He could get the full benefit of the Roth if he wanted to do a Roth and nobody shared that with him, not his accountant, not his financial advisor, his employer but he just assumed based on a long time ago when the rules were such that if you just made too much money, you couldn’t contribute. He didn’t realize some of the rules had allowed him to still contribute. You really want to look at that stuff. Don’t find out here as you get your return back all the opportunities that you missed. You want to get ahead of the curve and take advantage of what is available legitimately that you can reduce your tax bill and put yourself in a better position in the future. Larry, I really want to thank you for joining us again today. You’re a wealth of knowledge. You always enlighten me with some of the ideas and some of the things that are out there that I need to be aware of for myself and my clients as well as planning strategies. Thanks again for joining us.

20:27

LARRY: Thanks, Jim, always a pleasure.

20:28

JIM: Thanks for joining us this week and tune in again next week as we explore another phase of the Real Wealth process and remember, if anything you heard in today’s show you’d like to get more information about, contact your Real Wealth advisor. Also, if you feel that any of this information would be helpful to a friend or family member, just click the Forward to a Friend button.