SCIARABBA WALKER &CO LLP
CERTIFIED PUBLIC ACCOUNTANTS
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Why Consider a Trust?

—Linda Bruckner, CPA

I have seen some very complex planning done with trusts. The most unusual being the creation of about 25 interrelated trusts intended to generate so much confusion that if anyone ever made a claim against the grantor of the trusts, it would not be an easy task. This is asset protection to the extreme, and for most of us, not necessary. I have also seen instances where trusts were created on the advice of a professional but were never funded with the intended assets. Whatever the reason behind the creation of a trust, that goal cannot be accomplished unless assets are actually transferred into the trust.

So when does the creation and funding of a trust make sense?

There may be instances where creating and funding a trust during your lifetime is beneficial. These trusts are called “intervivos trusts.” Intervivos trusts can be either revocable (you can change your mind and undo the trust) or irrevocable. A trust created by your will at your death is called a “testamentary trust.”

Top 5 reasons for creating intervivos trusts:

1. **Your child or grandchild has special needs.** A trust can help provide a safety net for that child without affecting the ability of the child to receive the governmental assistance they may desperately need.
2. **You own property in a state other than the state in which you reside.** Placing such property in a trust can enable your executor to avoid probate in that other state.
3. **You wish to avoid probate in your own state of residency.** Assets in a trust, although generally included in your gross estate for estate tax purposes, are not part of your probate estate. Thus, the use of an intervivos trust can limit a disenfranchised party's ability to challenge who receives your assets at your death, protect confidentiality, and reduce or eliminate probate costs.
4. **You wish to keep life insurance out of your taxable estate.** A properly set up life insurance trust can keep life insurance proceeds from being subject to estate tax, while still providing liquidity for your estate.
5. **You wish to make a charitable contribution** during your lifetime but would like to receive the income from the donated property until your death. The use of a charitable remainder trust can accomplish such a goal and many charitable organizations already offer that option to their donors.

Top 5 reasons for creating testamentary trusts:

1. **You wish to make optimum use of the amount that can pass tax-free to the next generation,** without jeopardizing your spouse's financial security. A "credit shelter trust" can provide your spouse with financial security until his or her death without causing the trust assets to be included in your spouse's estate.
2. **You have remarried** and you would like some of your assets to pass to children from your first marriage, but not until after the death of your spouse. A trust can provide for the financial security of your spouse during his or her lifetime but direct that the ultimate disposition of the assets pass to other beneficiaries.
3. **You have minor children or grandchildren.** A trust enables you to leave assets to minors while restricting their use of such assets until they have reached an age of your choosing.
4. **You have a child or grandchild with special needs.** A trust enables you to leave assets to that child without affecting the ability of the child to receive the governmental assistance they may desperately need.
5. **You would like some or all of your assets to pass to a charitable beneficiary,** but not until after the death of your spouse. A trust can provide for the financial security of your spouse during his or her lifetime but direct that any remaining assets be distributed to the charity or charities of your choosing.

Whatever the reason for creating a trust, make sure you obtain competent tax and legal advice, and fund any intervivos trusts that you set up. Remember, a trust is only effective if it is actually funded!

Do you have NEXUS?

If you do, you won't need to see your doctor, but you will want to talk with your tax advisor.

Nexus is defined as: 1) a means of connection; tie; link. 2) a connected series or group.

Nexus is the term used to indicate conditions are in place to cause a taxpayer to be subject to taxation in a particular state. If you do business outside of your home state, you may have Nexus in one or more additional states and be required to file income tax returns in those states. Failure to file required returns can result in penalties and interest in addition to taxes due, which over time could exceed the taxes you should have paid initially.

With the economic downturn of the past few years, states are searching for additional sources of revenue. Many have turned to out-of-state companies to find needed revenue.

How can you know whether you have Nexus? Here are some basics to help you evaluate your particular situation. Keep in mind that Nexus rules vary from state to state, so you will need some help from an expert.

States impose a variety of taxes including, but not limited to:

- **Sales and Use Tax.** This is a tax imposed on the sales price of goods and services. Traditionally, states have only been allowed to require companies to collect and submit sales tax if the taxpayer had a physical presence within the state. States are becoming increasingly aggressive, however, in defining when a taxpayer has nexus for the purpose of sales and use taxes.
- **Income Tax.** Federal law provides some protection from states imposing income tax on out-of-state companies. Per federal law, states may not impose a tax based on net income to out-of-state taxpayers whose only connection with the state is the.... solicitation of orders for sales of tangible personal property when such orders are approved and shipped from outside the state. This law does not, however, apply to the sale of intangible property, real estate or services.
- **Franchise Tax.** This is a tax imposed for the privilege of doing business in a state. It is generally based on apportioned capital, net worth or another non-income base. If you have sales tax nexus in a state, you are

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Important

Are You Required to File Form 1099?

—Diane McDonough, CPA

If you operate a trade or business, it is important to review your cash disbursements at year-end to determine whether you have a 1099 filing requirement. Non-profit organizations, sole proprietors, corporations, partnerships, and farms are all subject to this filing. Personal payments are not reportable.

You are required to file a Form 1099 when certain payments are made to encourage the reporting of income, especially income earned by independent contractors. You must issue 1099s to recipients and file them with the IRS. Consequently, the IRS can verify the reported payments with the recipient's tax return to ensure that all of the income has been reported properly.

If you engage in a passive investment activity, such as rental real estate, then you are not considered to be engaged in a trade or business for the purpose of filing 1099s. However, you are considered for this filing if you are otherwise engaged in the trade or business of renting property as a real estate professional or property manager.

Each of your Form 1099 recipients should complete a W-9 Form to provide the information needed to satisfy the filing requirement. You can find the W-9 Form on the IRS web-site (www.irs.gov). We recommend obtaining this completed W-9 form **before** issuing payment to a service provider so you can ensure that you have acquired all of the necessary information.

The two most common types of Form 1099s are 1099-INT (to report interest income paid) and 1099-MISC (to report miscellaneous income payments).

You need to file Form 1099-INT for each person or business to whom you have paid the following during this year:

- At least $600 of interest in the course of your trade or business

You need to file Form 1099-MISC for each person or business to whom you have paid the following during this year:

- At least $600 in rents
- At least $600 in services (including parts and materials)
- At least $600 in prizes and awards
- Gross proceeds of $600 or more paid to an attorney
- At least $10 in royalties

Some payments are **not required** to be reported on Form 1099, although they may be taxable to the recipient. These generally include:

- Payments to a corporation (unless paid to an incorporated attorney and then they are reportable)
- Payments for merchandise, telephone, freight, storage, and other similar items
- Payments of rent to real estate agents
- Reimbursement for business travel expenses or payment of business travel allowances
- Payments to a tax exempt organization

Congress has passed more stringent penalties of up to $100 per unfiled 1099. In order to help determine who is compliant, the IRS has added two questions to each individual, corporate, partnership, and trust tax return:

- Did you make payments in (tax year) that would require you to file Form(s) 1099?
- If yes, did or will you file all required Forms 1099?

With the addition of these new questions, we will need to confirm that you have reviewed your cash disbursements to determine your filing requirements and have prepared or asked Sciarabba Walker & Co. to prepare all necessary forms before finalizing your tax return. Please be sure to let us know should you have any additional questions related to the filing of these year-end informational forms.

LEGISLATIVE UPDATE

—Amy Iles, CPA

With so much uncertainty surrounding the expiration of a host of reduced tax rates, credits, deductions and other incentives, what do we know for certain as 2012 draws to a close and we look at 2013?

- The elective deferral (contribution) limitation for employees who participate in 401(k), 403(b), and most 457 plans is increased from $17,000 to $17,500 for 2013.
- The catch up contribution limit for employees aged 50 and over who participate in these plans remains unchanged at $5,500 for 2013. The maximum you can contribute to all of your traditional and Roth IRAs in total is the smaller of $5,500 ($6,500 if you're age 50 or older) or your taxable compensation for the year, up from $5,000 in 2012.
- The deduction for taxpayers making contributions to a traditional IRA is phased out for singles and heads of household who are covered by a workplace retirement plan and have modified adjusted gross incomes (AGI) between $59,000 and $69,000, up from $58,000 and $68,000 in 2012. For married couples filing jointly, in which the spouse who makes the IRA contribution is covered by a workplace retirement plan, the income phase-out range is $95,000 to $115,000, up from $92,000 to $112,000. For an IRA contributor who is not covered by a workplace retirement plan and is married to someone who is covered, the deduction is phased out if the couple's income is between $178,000 and $188,000, up from $173,000 and $183,000.
- The AGI phase-out range for taxpayers making contributions to a Roth IRA is $178,000 to $188,000 for married couples filing jointly, up from $173,000 to $183,000 in 2012. For singles and heads of household, the income phase-out range is $112,000 to $127,000, up from $110,000 to $125,000. For a married individual filing a separate return who is covered by a retirement plan at work, the phase-out range remains $0 to $10,000.
- The annual exclusion for gifts rises to $14,000 for 2013, up from $13,000 in 2012. This means that an individual can gift up to $14,000 (married couples, $28,000) to another person without using any of their lifetime exclusion.
- Standard mileage rates used to calculate deductible costs of operating a motor vehicle for business, medical and moving purposes and charitable activities have increased to 56.5 cents per mile for business miles driven and 24 cents per mile for medical or moving purposes for 2013. The standard rate for miles driven in service of charitable organizations remains the same as in 2012, 14 cents per mile.
- Beginning January 1, 2013, medical Flexible Spending Account (FSA) contributions will be limited to $2,500 per year, per employee. Those businesses selecting their medical FSA contribution within the 2012 calendar year will not be affected by the pending FSA cap until the following plan year.
- An additional Medicare contribution tax equal to 0.9% of wages and self-employment income will be imposed on single taxpayers' earnings in excess of $200,000 and married filing joint taxpayers' earnings in excess of 250,000. Employers will be required to withhold this tax on wages in excess of $200,000.
- A 3.8% surtax on unearned income including passive income from LLC's, partnerships, S corporations and most rental activities will be assessed to higher income individuals with modified adjusted income in excess of $200,000 for a single individual and $250,000 for a married filing joint couple.
- Estates and trusts will be subject to a 3.8% tax on the lesser of undistributed net investment income for the tax year or adjusted gross income in excess of the dollar amount at which the highest tax bracket for trusts and estates begins for that tax year (estimated at $11,950 for 2013). The 3.8% tax does not apply to a trust in which all of the unexpired interests are devoted to charitable purposes.
- The threshold to claim an itemized deduction for unreimbursed medical expenses increases from 7.5% of adjusted gross income in 2012 to 10% of adjusted gross income in 2013. Taxpayers age 65 and older are exempt from the increased threshold until 2017.
- The dollar amounts for Section 179 expensing are scheduled to be $25,000 with a phase-out of $200,000 in 2013, down from $139,000 with a phase-out of $560,000 in 2012. Although there is a chance the 2013 figures will go up if Congress acts, it would be wise to place more assets in service in 2012 if you have not yet maximized the $139,000 threshold.
- Bonus depreciation is not scheduled to apply in 2013.
- Employers who filed at least 250 Forms W-2 in 2011 are required to disclose the aggregate cost of applicable employer-sponsored health insurance on an employee's W-2 for tax years beginning after January 1, 2011. Reporting is for informational purposes only. Employers with less than 250 employees are exempt from this filing requirement until further guidance is issued.

It will be especially important this year to align traditional year-end planning techniques with strategies for dealing with the uncertainties created by Congress's delay in addressing sunsetting tax rates and the extension of other major tax benefits. Strategies in response to the 3.8% Medicare contribution tax should also be considered. If you have not already scheduled an appointment for year-end tax planning with us, please consider doing so at your earliest convenience.

NEXUS?

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likely to also have nexus for the purpose of the state's franchise tax.

- **Other Business taxes.** These are taxes based on gross receipts from the sale of products or services or other modified bases.
- **In addition,** you may have to include information from "affiliated" businesses even if they do not have any direct connection with the state.

Now that we know the various types of taxes imposed by states, let's take a look at situations that could create Nexus in a state:

- **Owning or leasing property:** If you own or lease real property, such as a store, office, warehouse, that is located in a state, you are likely to have nexus in that state. Personal property (machinery or equipment) located in the state applies as well.
- **Inventory:** Maintaining inventory within a state, even if that inventory is consigned or carried by sales representatives can create Nexus.
- **Deliveries:** Deliveries into a state by other than the US Postal Service or common carrier can create nexus. So, if you use company vehicles to deliver products out-of-state you may be subject to taxation in that state.
- **Advertising:** Advertising in local media or through a telemarketing firm physically located in a state may also be viewed as creating Nexus.
- **Employees:** If employees are physically present in the state for more than a de minimis period of time to perform services, such as installation, warranty repair, maintenance or other similar services nexus may be created. This includes employees who work remotely from another state even if they do so occasionally and third-party subcontractors. Nexus may also be created when employees are in the state to attend trade shows, company meetings, training or seminars.
- **Solicitation:** Active solicitation of orders for sales of tangible personal property through employees, agents or independent representatives could create sales tax Nexus. Sales of products or services over the internet and contracts with "affiliates" who post Web links from their in-state website to your company's out-of-state website can also create sales tax Nexus. This has recently come to light in a court case between Amazon.com and the state of New York where Amazon created Nexus by allowing New York residents to place links to amazon.com on their own website and were rewarded with a referral fee. In another case, the Connecticut state Supreme Court ruled that Scholastic, Inc. created Nexus in Connecticut by selling books to children using teachers as their sales force.
- **Fees:** If you charge a license, royalty or similar fee for the use of intangible assets such as trademarks, trade names, software, etc. to entities in another state, you may also create Nexus.

If you had filing requirements in one or more states for past tax periods, many states offer Voluntary Disclosure Agreements or VDA's which can offer some protections, such as limiting the look back period for filing and paying taxes from prior years and waiver of penalties. Nexus is a complex topic requiring specialized knowledge and research, so if you think you might have nexus in one or more states, it is best to talk with your tax professional and ensure you are filing tax returns in all states as required.

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