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WOB ACCOUNTANTS AND ADVISORS

Client Bulletin

Smart Tax, Business & Planning Ideas *from your* Trusted Business Advisor[sm]

April 2015

Are Tax Refunds Good or Bad?

Few people pay exactly the correct amount of income tax during the year. When you file your return for 2014, you probably will find that you paid too little (and owe more tax) or paid too much (and can request a refund). Typically, refunds are due to employees who have too much tax withheld from their paychecks.

Example 1: Arlene King is paid twice a month. From each paycheck, her employer withholds $1,000 for federal income tax, so Arlene's tax payments for 2014 were $24,000. When Arlene files her 2014 tax return, she sees that her tax obligation for last year was $21,000. Thus, Arlene can request a $3,000 tax refund.

Does over-withholding and getting a refund in this manner make sense financially? That depends on a taxpayer's situation.

Positive features

The advantage of getting a tax refund is, well, who wouldn't want to receive a large check from the federal government? Moreover, federal income tax refunds aren't taxable. (A state or local tax refund may increase the tax you'll owe.)

Thus, Arlene may decide to use her $3,000 refund check to invest or to pay down debt or to make a special purchase. In effect, her $3,000 of excess tax withholding becomes a form of forced saving, which she can utilize every year when the check comes in.

Now for the negatives

On the other hand, having too much money withheld for income tax has been likened to making an interest-free loan to the IRS. It's your money—you earned it—so why wait for months to get your hands on it? This strategy can be especially unappealing if your over-withholding results from a major change in your life.

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Plumper payouts

U.S. dividend increases totaled $54.8 billion in 2014 as 3308 stocks increased their payouts, up from 2895 stocks in 2013.

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Trusted Advice

Adapting allowances

- On IRS Form W-4, employees can claim a number of personal allowances.
- The more allowances you claim, the lower your withholding and the more income you'll receive with each paycheck.
- Two income couples can calculate the total number of allowances to which they're entitled.
- For such couples, withholding usually will be most accurate when all allowances are claimed on the Form W-4 for the higher earning spouse.
- The lower earning spouse then can claim zero allowances on his or her Form W-4.

Example 2: In early 2014, Bianca and Craig Carter bought a house, using a large mortgage for the purchase. Bianca left her job to stay home with their young child. Thus, the Carters had lower income and higher deductions than in 2013, resulting in a smaller tax bill.

However, Craig did not adjust his tax withholding at work. Thus, he paid more tax than necessary throughout the year. It's true that the Carters will get back the overpayment with a 2015 tax refund, but they went through 2014 with less cash flow than required, forcing them to struggle to cover the costs of a new home and a growing family.

Winning the numbers game

If you feel that you need the disciplined forced savings of over-withholding, then relying on an annual tax refund may make sense. Conversely, if you prefer to get your money as you earn it, you can reduce the amount withheld by filling out IRS Form W-4, Employee's Withholding Allowance Certificate, and submitting it to your employer. Our office can help you fill out Form W-4 so you get the right amount withheld, avoiding either a large refund or a large tax obligation with next year's tax return. ■

Did You Know?

The federally sponsored Pension Benefit Guaranty Corp. provides benefits to participants in terminated private sector plans. The maximum guaranteed benefit for a 65-year-old retiree getting a single-life annuity is $60,136 in 2015. For joint-and-50% survivor annuities, the maximum payment this year to a 65-year-old couple is $54,123.

Source: pbgc.gov

Seeking Safety in Long-Term Treasuries

Since the financial panic of late 2008, U.S. stocks have posted positive returns for six consecutive calendar years. As of this writing, major market indexes are not far below record levels. Although the future is unpredictable, it's possible that a moderate or even a sharp reversal will occur.

Concerned investors might reduce allocations to stocks and raise their holdings of bonds, especially long-term U.S. Treasuries, which historically have offered a safe haven in tumultuous times. In 2008, for instance, most investments plunged, but long-term Treasuries thrived—Morningstar reports that long-term government bonds returned almost 26%. When the going gets tough, many investors get going into U.S. government bonds with maturities over 10 years.

Ample advantages

With or without a stock market setback, long-term Treasuries have appealing features. There's little risk that investors will not be repaid by the borrower—the federal government. They are easy for individuals to buy; just go to www.treasurydirect.gov/tdhome.htm and provide the requested information. There are no fees for buying or holding Treasuries there, and the minimum purchase is just $100.

As you might expect for a safe investment, yields on long-term Treasuries are modest in today's low yield environment. Yet, they're not negligible. Currently, long-term Treasuries yield from 2% to 2.5%, depending on years to maturity. That's more than bank accounts and money market funds are paying now. When you buy long-term Treasuries, you're locking in that yield for the next 10 to 30 years.

If you prefer to invest through funds, you can choose among many that hold long-term Treasuries, including some with very low expenses for investors. Yields typically aren't locked in because these funds keep acquiring additional issues, with higher or lower yields. Today, some popular long-term government bond funds have yields of 2.6% or higher.

What's more, interest from Treasury bonds is exempt from state and local income tax. Thus, Treasury issues may appeal to residents of high-tax states and localities.

Predicting interest rate movements and the impact on bond prices is always difficult. Nevertheless, there are some positive signs for long Treasuries now. Historically, interest rates have moved higher—driving bond prices lower—during inflationary times. Inflation currently does not appear to be a major concern, especially with oil prices at reduced levels.

In addition, the U.S. dollar has been appreciating versus other currencies, and a strong dollar may create worldwide demand for U.S. government bonds. Altogether, low inflation and a robust dollar might keep the price of long-term Treasuries from falling. Some financial advisors believe that allocating about 10% of an investment portfolio to long-term Treasuries is prudent now. These bonds may offer decent yields as well as a hedge against possible weakness in economic growth, corporate profits, and stock prices.

Risk factors

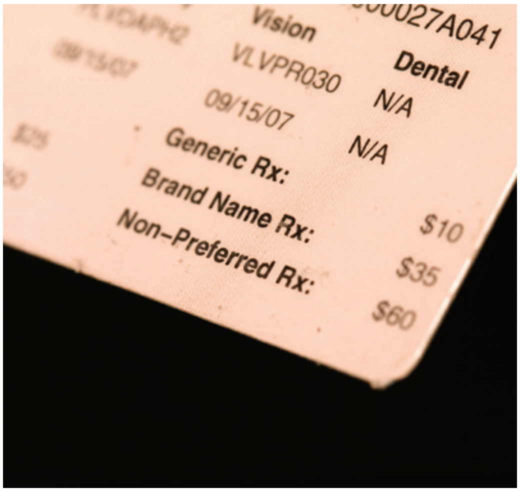
Nevertheless, long-term Treasuries can pose concerns for investors. Locking in 2%–2.5% yields for 10 years or longer might not turn out to be a good decision if interest rates rise from today's low levels. Higher interest rates will bring down bond prices, and long-term issues usually suffer the largest loss of principal.

In 2009 and 2013, long-term government bonds lost 15% and 11% of their value, respectively, while intermediate-term government issues lost only 2% and 1%. To some skeptics, buying long-term Treasuries today means putting risk into supposedly safe government-backed securities, and 2%–2.5% yields don't justify taking such risks.

Indeed, today's interest rates are as low as they've been since the post-World War II period. Subsequently, long-term government bonds returned barely 2% a year from 1951 through 1981, less than half the annualized rate of inflation, which was over 4%.

If you have doubts about long-term Treasuries, what investments might provide steady income as well as a hedge against a potential stock market slide? Options range from dividend-paying stocks to shorter-term Treasuries to municipal bonds. No investment is without risk; long-term Treasuries have their strong points, but you should consider all the possible consequences of including them in a diversified portfolio. ■

Private Health Insurance Exchanges for Business Owners



The public health insurance exchanges created under the Affordable Care Act have been well publicized. Another, not so well known option exists: private health insurance exchanges. The private entries are still relatively small; in late 2014, the Kaiser Family Foundation put total enrollment at 2.5 million people, including 700,000 retirees in Medicare plans.

Yet, some observers see the private market expanding to as many as 40 million people by 2018. While public health insurance exchanges focus largely on individual and family plans, some of the private exchanges appeal mainly to employers. Owners of small companies as well as decision makers at medium-sized and large firms may evaluate the benefits of providing employee health insurance coverage through private exchanges.

Multiple choices

Unlike public exchanges, which are offered by the federal and state governments, private exchanges are run by a variety of companies. Sponsors include consultants, brokerage firms, even retailers. The constant is that these exchanges allow those seeking health insurance to go online and compare what's available in a virtual marketplace.

Private health insurance exchanges can take many forms, but

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one likely structure is the defined contribution plan. Just as traditional defined benefit retirement plans have lost ground to defined contribution retirement plans, such as 401(k)s, so traditional employer health plans may be supplanted by defined contribution arrangements.

Here, the "defined contribution" could be the amount an employer gives its employees to shop for coverage on a private exchange.

Example: Melanie Wilson owns a small business with 25 employees. She enters into an agreement with a health insurance exchange managed by an employee benefits firm. Melanie's employees will be able to go online and examine the offerings from three specified health insurers; each health insurer will make four different plans available. Employees can choose among the offerings as they'd choose among the investment options of a 401(k) plan.

Melanie decides to allow each employee to spend up to $300 a month on health insurance. If Bob Smith picks a plan that costs $400 a month, Bob will have to contribute the extra $100 each month; if Claire Jones picks a plan that costs only $250 a month, Claire might use the extra $50 for some other type of coverage, such as disability insurance.

If handled properly, Melanie's outlays will be treated as tax-deductible business expenses for the company, while her employees will not have to include the $300 monthly allowance as taxable income. That's how today's standard health insurance plans are taxed.

Cost control

Advocates of private health insurance exchanges say that they can help employers control expenses and reduce paperwork responsibilities. Employees not only get to choose a plan that fits their needs and finances, they'll also gain an appreciation of how much of the health care costs employers are bearing.

Nevertheless, there can be drawbacks to private exchanges. Coverage won't qualify for the subsidies that public exchanges may deliver. The area is still new, so there's not much of a track record to examine. If your company is interested in exploring the idea of a private health insurance exchange for its employees, our office can help you compare the costs and benefits with those of your present health plan. ■

TAX CALENDAR

APRIL 2015

April 15

Individuals. File a 2014 income tax return. If you want an automatic six-month extension of time to file the return, file Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return. Then, file Form 1040, 1040A, or 1040EZ by October 15.

If you are not paying your 2015 income tax through withholding (or will not pay in enough tax during the year that way), pay the first installment of your 2015 estimated tax. Use Form 1040-ES.

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in March if the monthly rule applies.

Household employers. If you paid cash wages of $1,900 or more in 2014 to a household employee, file Schedule H (Form 1040) with your income tax return and report any household employment taxes. Report any federal unemployment (FUTA) tax on Schedule H if you paid total cash wages of $1,000 or more in any calendar quarter of 2013 or 2014 to household employees. Also report any income tax you withheld for your household employees.

Partnerships. File a 2014 calendar year return (Form 1065). Provide each partner with a copy of Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc., or a substitute Schedule K-1. If you want an automatic five-month extension of time to file the return and provide Schedule K-1 or a substitute Schedule K-1, file Form 7004. Then file Form 1065 by September 15.

Electing large partnerships. File a 2014 calendar year return (Form 1065-B). If you want an automatic six-month extension of time to file the return, file Form 7004. Then file Form 1065-B by October 15.

Corporations. Deposit the first installment of estimated income tax for 2015.

MAY 2015

May 11

Employers. For Social Security, Medicare, and withheld income tax, file Form 941 for the first quarter of 2015. This due date applies only if you deposited the tax for the quarter in full and on time.

May 15

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in April if the monthly rule applies.

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