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Newsletter

OCTOBER 2014

Tax filing reminders

- **October 1** – Generally, the deadline for businesses to adopt a SIMPLE retirement plan for 2014.
- **October 15** – Filing deadline for 2013 individual tax returns on automatic six-month extension of the April 15 deadline.
- **October 15** – If you converted a regular IRA to a Roth in 2013 and now want to switch back to a regular IRA, you have until October 15, 2014, to do so without penalty.

Investing in mutual funds? Watch for year-end tax issues

Mutual funds offer an efficient means of combining investment diversification with professional management. Their income tax effects can be complex, however, and poorly timed purchases or sales can create unpleasant year-end surprises.

Mutual fund investors (excluding qualifying retirement plans) are taxed based on activities within each fund. If a fund investment generates taxable income or the fund sells one of its investments, the income or gain must be passed through to the shareholders. The taxable event occurs on the date the proceeds are distributed to the shareholders, who then owe tax on their individual allocations.

If you buy mutual fund shares toward the end of the year, your cost may include the value of undistributed earnings that have previously accrued within the fund. If the fund then distributes those earnings at year-end, you'll pay tax on your share even though you paid for the built-up earnings when you bought the shares and thus realized no profit. Additionally, if the fund sold investments during the year at a profit, you'll be taxed on your share of its year-end distribution of the gain, even if you didn't own the fund at the time the investments were sold.

Therefore, if you're considering buying a mutual fund late in the year, ask if it's going to make a large year-end distribution, and if so, buy after the distribution is completed. Conversely, if you're selling appreciated shares that you've held for over a year, do so before a scheduled distribution, to ensure that your entire profit will be treated as long-term capital gain.

Most mutual fund earnings are taxable (unless earned within a retirement account) even if you automatically reinvest them. Funds must report their annual distributions on Forms 1099, which also indicate the nature of the distributions (interest, capital gains, etc.) so you can determine the proper tax treatment.

Outside the funds, shareholders generate capital gains or losses whenever they sell their shares. The gains or losses are computed by subtracting selling expenses and the “basis” of the shares (generally purchase costs) from the selling price. Determining the basis requires keeping records of each purchase of fund shares, including purchases made by reinvestments of fund earnings. Although mutual funds are now required to track and report shareholders’ cost basis, that requirement only applies to funds acquired after 2011.

When mutual funds are held within IRAs, 401(k) plans, and other qualified retirement plans, their earnings are tax-deferred. However, distributions from such plans are taxed as ordinary income, regardless of how the original earnings would have been taxed if the mutual funds had been held outside the plan. (Roth IRAs are an exception to this treatment.)

If you’re considering buying or selling mutual funds and would like to learn more about them, give us a call.

Accurate inventory numbers are important

For many companies, inventory is a significant dollar amount on the company’s financial statements. So it’s crucial that recorded inventory balances reflect actual values. When such accounts aren’t properly stated, the cost of goods sold and current ratios – numbers that often matter to decision makers – may be skewed. If banks discover that your company’s inventory accounts are overstated, they may not extend credit. If, when necessary, inventories aren’t “written down” (their values lowered in the accounting records), fraud may go undetected or the company’s net profits may appear unrealistically rosy.

Inventories decline in value for a variety of reasons. You might be in the business of selling electronic equipment to retail customers. Over time, yesterday’s “latest and greatest” gadgets become today’s ho-hum commodities. Such goods still have value, but they can’t be sold at last year’s prices. Your inventory is experiencing “obsolescence.”

Inventory “shrinkage” is another term that’s often used to describe declining inventory values. Let’s say you run a construction materials company. Unbeknownst to you, a dishonest supervisor is skimming goods from your shelves. A periodic inventory count that’s compared to your company’s general ledger might show that inventory is declining faster than it’s being sold. As a result, you may decide to investigate and to reduce inventory values in your accounting records.

Other examples of shrinkage might include a retail store that loses inventory due to shoplifting or a warehouse facility that’s hit by a storm. In both cases, inventories may need to be written down in the company books to more accurately reflect actual values. Under another scenario, a shady supplier might bill your company for goods that aren’t actually shipped or received. Your inventory may end up being overstated.

For some companies, several sources feed into inventory values. A manufacturing concern, for example, might add all the expenses needed to prepare goods for sale – including factory overhead, shipping fees, and raw material costs – into inventory accounts. When those supporting costs fluctuate, inventory accounts are often affected.

To ensure that your inventory numbers remain accurate, it’s a good idea to conduct regular physical counts and routinely analyze the accounts for shrinkage, obsolescence, and other evidence of diminishing value.

Check your 2014 tax payments

Don’t let penalties for underpaid taxes increase your tax bill next April. Check the total you’ve paid in for 2014 through withholding and/or estimated taxes. If you’ve underpaid, consider adjusting your withholding for the final months of 2014 or increasing your remaining quarterly estimate. If you employ household workers, be sure your calculations include the payroll taxes you’ll owe for them.