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Tax & Business Alert

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GOT NEXUS? FIND OUT BEFORE OPERATING IN MULTIPLE STATES

For many years, business owners had to ask themselves one question when it came to facing taxation in another state: Do we have “nexus”? This term indicates a business presence in a given state that’s substantial enough to trigger the state’s tax rules and obligations.

Well, the question still stands. And if you’re considering operating your business in multiple states, or are already doing so, it’s worth reviewing the concept of nexus and its tax impact on your company.

COMMON CRITERIA

Precisely what activates nexus in a given state depends on that state’s chosen criteria. Triggers can vary but common criteria include:

- Employing workers in the state,
- Owning (or, in some cases, even leasing) property there,
- Marketing your products or services in the state,
- Maintaining a substantial amount of inventory there, and
- Using a local telephone number.

Then again, one generally can’t say that nexus has a “hair trigger.” A minimal amount of business activity in a given state probably won’t create tax liability there.



For example, an HVAC company that makes a few tech calls a year across state lines probably wouldn’t be taxed in that state. Or let’s say you ask a salesperson to travel to another state to establish relationships or gauge interest. As long as he or she doesn’t close any sales, and you have no other activity in the state, you likely won’t have nexus.

STRATEGIC MOVES

As with many tax issues, the totality of facts and circumstances will determine whether you have nexus in a state. So it’s important to make assumptions either way. The tax impact could be significant, and

SERVICE COMPANIES, BEWARE OF MARKET-BASED SOURCING

Nexus has been and remains the primary focus of companies considering whether and how they'd be taxed across state lines. (See main article.) But, recently, many states have established "market-based sourcing" for determining the tax liability of *service* companies that operate within their borders.

Under this approach, if the benefits of a service occur and will be used in another state, that state will tax the revenue gained from said service. "Service revenue" generally is defined as revenue from *intangible* assets — not the sales of tangible personal property.

Thus, in market-based sourcing states, the destination state of a service is the relevant taxation factor rather than the state in which the income-producing activity is performed (also known as the "cost of performance" method).

its specifics will vary widely depending on just how the state in question approaches taxation.

For starters, strongly consider conducting a nexus study. This is a systematic approach to identifying the out-of-state taxes to which your business activities may expose you. The results of a nexus study may not necessarily be negative. You may find that your company's overall tax liability is lower in a neighboring state. In such cases, it may be advantageous to create

nexus in that state by, say, setting up a small office there. If all goes well, you may be able to allocate some income to that state and lower your tax bill.

TAXATION AND PROFITABILITY

"The grass is always greener on the other side of the fence," so the saying goes. If profitability beckons in another state, please contact our firm for help projecting how setting up shop there might affect your tax liability. ■

4 TIPS FOR DONATING ARTWORK TO CHARITY

Individuals may want to donate artwork so it can be enjoyed by a wider audience or available for scholarly study or simply to make room for new artwork in their home. Here are four tips for donating artwork with an eye toward tax savings:

1. Get an appraisal. Donations of artwork valued at over \$5,000 require a "qualified appraisal" by a "qualified appraiser." IRS rules detail the requirements. In addition, auditors are required to refer all gifts of art valued at \$20,000 or more to the agency's Art Advisory Panel. The panel's findings are the IRS's official position on the art's value, so it's critical to provide a solid appraisal to support your valuation.

2. Donate to a public charity. Donations to a qualified public charity (such as a museum or university) potentially entitle you to deduct the artwork's full fair market value. If you donate to a private foundation, your deduction will be limited to your cost. The total amount of charitable donations you may deduct in a given year is limited to a percentage of your adjusted gross income (50% for public charities, 30% for private foundations) with the excess carried forward for up to five years.



3. Beware the related-use rule. To qualify for a full fair-market-value deduction, the charity's use of the artwork must be related to its tax-exempt purpose. Even if the related-use rule is satisfied initially, you may lose some or all of your deductions if the artwork is worth more than \$5,000 and the charity sells or otherwise disposes of it within three years of receipt. If that happens, you may be able to preserve your tax benefits via a certification process. (For further details, please contact us.)

4. Consider a fractional donation. Donating a fractional interest allows you to save tax dollars without completely giving up the artwork. Say you donate a 25% interest in your art collection to a museum for it to display for three months annually. You could then deduct 25% of the collection's fair

market value and continue displaying the art in your home or business for most of the year.

The rules for fractional donations, and charitable contributions of artwork in general, can be tricky. Plus, tax law changes affecting deductions may occur in the coming year. Contact our firm for help. ■

IDENTIFYING QUALIFYING CHILDREN FOR TAX PURPOSES

As you file your 2016 income tax return, you may be wondering whether you're eligible for tax breaks related to a niece who lives with you, or perhaps a stepson who spends only part of the year in your home. It all depends on whether, for federal tax purposes, that person is your "qualifying child."

WIDELY APPLICABLE

In an effort to simplify the tax code and eliminate confusion, Congress established a uniform definition of "qualifying child" as part of the Working Families Tax Relief Act of 2004. The definition applies for purposes of several child-related tax benefits, such as:

- Dependency exemptions,
- The child tax credit,
- The child and dependent care credit, and
- Head-of-household filing status.

The definition relies on residency rather than requiring that you have provided more than half of a dependent's support, as was the case years ago.

4 TESTS TO PASS

More specifically, a qualifying child must meet four tests:

1. Relationship. The definition applies to your child (including one who's adopted or who's an eligible foster child), stepchild, brother, sister, stepbrother or stepsister. It also includes any of their descendants. So, for example, your grandchildren, nieces and nephews also qualify.

2. Age. A child must be under age 13 when the care was provided to qualify for the child and dependent care credit, under age 17 (as of the end of the year) for the child credit and under age 19 (age 24 for a full-time student) for the other tax benefits. Except for the child credit, there's no age limit for a permanently disabled person.



3. Residence. The child must share your principal place of abode for more than half the year, which includes time spent away from home because of school, military service or illness.

4. Support. It's no longer necessary for you to provide more than half of a child's support. But the qualifying child generally can't provide more than half of his or her own support.

Under the current definition, the child must be a citizen or resident of the United States, Canada or Mexico to qualify. However, if the child files a joint return, he or she won't qualify. If more than one person claims a benefit with respect to the same child, the tax code specifies who's entitled to tax benefits.

If two or more people are eligible to claim the same child as a dependent, they can decide among themselves who will claim the tax benefits. In the event that more than one person actually claims those benefits, there are a variety of rules in place to break the tie.

FURTHER QUESTIONS

As you can see, the Internal Revenue Code recognizes that families take care of each other and not every child claimed in relation to tax benefits will be a biological child. If you have further questions about this topic, please contact our firm. ■

YOU'VE HIT THE JACKPOT! NOW WHAT?

When it comes to financial planning, most of us spend our time guarding against things that could go wrong. But what if something really *good* happens? Hitting the jackpot is obviously a nice problem to have. Yet an unexpected influx of cash can drive even savvy individuals to do regrettable things.

Your first impulse upon experiencing a financial windfall may be to shout about it from the rooftops. But it's likely wiser to lie low and consider your options. A substantial sum of money could compel long-lost acquaintances and family to suddenly get in touch. And let's not even get into the identity theft risks.

Naturally, you'll need to consider the tax ramifications. There's no shortage of cautionary tales about the suddenly rich who've gotten into trouble with the IRS.

There are also family issues to consider. If you have minor children, you may want to establish trusts so that, should something happen to you, their finances will be well managed. Likewise, you may need to establish or rethink your estate plan to preserve



family harmony and ensure your wishes are fulfilled after you die.

Reassess your insurance needs, too. Your newfound wealth may make you a bigger target for lawsuits should an accident occur on your property or while you're driving. Ask your insurance agent to review your existing coverage.

If good fortune has smiled upon you, please contact us. We can help ensure you don't underestimate the amount of taxes you'll have to pay, as well as assist you in planning your financial future. ■