



Client Bulletin

Smart Tax, Business & Planning Ideas *from your Trusted Business Advisor*SM

Should You Pay Summer Interns?

June 2016



Each year, many companies—large and small—offer summer internships. The interns are frequently college students between academic years, and they usually are unpaid. Recently, such arrangements have come under fire from those contending interns should be put on the payroll.

The advantages of unpaid internships are clear: Companies probably have relatively low financial obligations for the services of their interns. Especially in the

summer, when many employees are on vacation, it may be helpful to have extra individuals around. If interns make a favorable impression, they might provide employers with a stream of productive, paid employees in the future.

Alternatively, various advocates assert that interns are truly employees, who should be paid for the work they do. The federal Department of Labor (DOL) apparently takes this view, at least in many circumstances. The DOL has published a six-part test, all parts of which must be met, in order for a for-profit firm to justify *not* paying interns. The key point is that an internship must be training that benefits the intern, without any current benefit to the employer. Failing to pass the six-point test, an employer must compensate interns according to the law for the services performed, by this standard.

Mixed messages

Not everyone accepts the DOL's view. Last year, in *Glatt et al. v. Fox Searchlight Pictures et al.* (7/2/15), the U.S. Court of Appeals for the Second Circuit vacated a district court's ruling in favor of former interns who sought after-the-fact compensation. The appeals court said of the DOL's six-part test, "[w]e do not find it persuasive, and will not defer to it." Instead, the Second Circuit

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Tax Fraud Flare-Up

The IRS reported a 400% surge in bogus email schemes ("phishing" and "malware") during the 2016 tax filing season.

stated that the question of required pay revolves around which party was the primary beneficiary of the arrangement, and sent the case back to the district court.

Given this background, how should business owners proceed if they offer or are thinking about offering internships? An astute first

step is to consult an attorney. Get an opinion about the status of local law and legal advice about how to structure your internship program.

In any case, business owners should carefully consider whether they want to offer unpaid internships. How much will you truly save by not paying interns?

Does that savings outweigh the potential future recruiting benefits of paying your interns and the reduced exposure to future legal challenges? Both sides may have valid points, but you should take a clear view of the issue before making decisions. ■

Planning for Today's Pensions

Some observers have commented that few private sector workers can look forward to pensions after retirement. The traditional pension, a lifelong stream of income to a retiree and perhaps a surviving spouse, is becoming a rarity for those who are not long-term government employees.

Nevertheless, millions of people do have a form of pension these days, one that kicks in after age 70½. At that age, required minimum distributions (RMDs) typically begin from retirement plans, such as traditional IRAs and 401(k)s. With proper planning, RMDs can serve as a long-term pension and also provide benefits to a surviving spouse.

How RMDs work

Beyond age 70½, you generally must withdraw at least a certain amount from your retirement plan each year. The number is based on your age and the account balance at the end of the previous year. Any shortfall triggers a 50% penalty.

Example 1: Craig Jackson will reach age 70 this July, so he'll be 70½ in January 2017. His first RMD will be for 2017, based on his December 31, 2016, IRA balance.

Assume Craig's IRA balance will be \$600,000 then. He can go to the IRS "Uniform Lifetime Table" and find age 71: the age he'll turn in 2017. The IRS table shows a "distribution period" of 26.5 years at 71, so Craig

will divide his \$600,000 IRA balance by 26.5, to get \$22,642, his RMD for the year. (IRA owners whose spouse is their sole beneficiary and is more than 10 years younger use a different table, resulting in a smaller RMD.)

Craig can withdraw a larger amount in 2017, but a smaller distribution will be penalized. If his 2017 IRA distributions total \$10,000, he'll lag the RMD by \$12,642 and owe a 50% penalty: \$6,321.

Each year, Craig will repeat the process, using the relevant distribution period and IRA balance. In the year he turns 76, for instance, the distribution period will be 22 years, reflecting a reduced life expectancy. If Craig has a \$440,000 IRA balance on the previous December 31, his RMD would be \$440,000/22, or \$20,000 that year.

Pension planning

By following the RMD guidelines, Craig can construct a do-it-himself pension. He can contact his IRA custodian early in 2017, determine his RMD for the year, and request the annual amount to be paid in monthly installments.

Example 2: In our previous example, Craig's 2017 RMD will be \$22,642. That's \$1,887 per month, for 12 months. Craig can have the IRA custodian transfer that amount into his checking account each month, which effectively would

provide him a pension for the year. The monthly RMD payouts would vary in future years, as explained. RMDs from traditional IRAs generally are fully or mostly taxable, so Craig can choose to have taxes withheld, reducing the monthly deposit. Alternatively, Craig can receive the full RMD each month and make quarterly estimated tax payments.

Using the IRS table in this manner, year after year, Craig will never deplete his IRA, so he'll always have monthly cash flow. If he reaches age 90, for example, the distribution period on the uniform table will be 11.4 years, meaning that Craig's RMD will be about 8.8% of his IRA.

Did You Know?

Four of the 10 most costly U.S. catastrophes on insured property occurred in 2004 and 2005. They include Hurricane Katrina, which cost \$41.1 billion, (then the costliest of all events on record) as well as hurricanes Charley, Ivan, and Wilma. As of last report, through 2014, the most severe event since then—number 10 on the list—was the 2011 Tuscaloosa, Alabama tornado, which cost \$7.3 billion.

Source: National Association of Insurance Commissioners

The balance can stay in the IRA, growing tax-deferred.

If Craig's wife, Dana, survives him, and Dana is the sole IRA beneficiary, she can roll Craig's IRA into her own name. Then Dana can have her own RMD schedule—her own lifelong pension—in addition to RMDs from any IRAs Dana already has established herself.

Note that Dana and Craig can take more than the RMD obligation each year. As long as they are older than 59½, there will be no early

withdrawal penalties. However, taking more than the RMD likely will increase the tax bill and reduce the amount of future cash flow from IRAs.

Easier riding

If you don't need money from your IRA in retirement, following the RMD table is the best way to minimize unwanted taxes. But what if you are relying on those funds for a comfortable lifestyle after you stop working? Then the IRS table

can deliver a practical guideline for tapping your retirement fund.

By following the table, you will withdraw more from your IRA after a period of successful investing, and less after a market pullback has devalued the account. You won't have to worry about how much or how little to take out, with every hiccup of the financial markets. RMD-based IRA withdrawals, along with Social Security checks, can provide a lifetime stream of cash flow. ■

Putting Your Money Into Timeshares

Does it make sense to buy a timeshare? Negative opinions are easy to find, and there's little doubt that high-pressure sales pitches may lead to some bad decisions.

Nevertheless, millions of Americans own timeshares. Surveys indicate that purchasers tend to be well educated, with comfortable incomes. Can so many capable and accomplished people all be wasting their money?

The answer to these questions is that timeshares can't be crammed into a single basket and treated as a universal good or bad deal. There are an infinite number of buying opportunities, with enormous variations from one arrangement to the next. If you look at a timeshare as a big-ticket purchase rather than as an investment, and if you read the terms of the agreement carefully before making any commitment, you might decide to add a timeshare to your vacation plans. Or you might not.

Old and new

Buying a timeshare essentially means prepaying for lodging on future vacations. Originally, buyers had a fixed destination.

Example 1: Mel and Lana King bought a timeshare many years ago

for \$15,000. This entitled them to a two-week stay at Resort A, in Room B, at a set time period each year. This sort of arrangement might work well if the Kings wish to spend the same two weeks at the beach every year. If they change their mind, the Kings might be able to rent the room and collect a fee (depending on the contract terms); alternatively, they could let friends or relatives use their slot.

As you can see, such arrangements lack flexibility. The Kings' circumstances might change, and the same yearly vacation plan might lose appeal. Thus, timeshare companies have sought ways to bring choice into the timeshare experience. Now, many deals involve points, rather than some sort of room swap.

Example 2: Jim and Hope Grant put \$25,000 into a timeshare last year. Instead of the right to use a specific room, they purchased an annual allotment of 200 "points" in a hotel chain's timeshare network. Each year, they can use those 200 points to stay at a vacation destination listed at 200 points on the network. One year, the Grants' 200 points might cover two weeks in a typical resort guest room; the next year, the same 200 points could allow the Grants to stay

Trusted Advice

Taxing Timeshares

- ▶ Generally, the tax benefits of putting money into a timeshare are limited.
- ▶ You may be able to deduct property tax if you itemize deductions. You'll need to be able to identify how much of your annual maintenance goes for property tax.
- ▶ Similarly, you might be able to deduct interest, if you finance your purchase. Several rules must be followed, including: you're not allowed to deduct home mortgage interest on more than two residences, and the loan must be secured by the timeshare you purchased.
- ▶ A loss on a timeshare sale typically is not deductible. A gain will be taxable, but favorable long-term capital gains rates apply on a timeshare held more than one year.
- ▶ Different rules apply if you rent your timeshare. Contact our office for assistance in tracking income and expenses.

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for one week in a luxurious suite with a beautiful view. And so on.

Pros and cons

Timeshare enthusiasts express many reasons to make this choice. You're guaranteed a place to stay on vacation, perhaps an extremely desirable one, without having to purchase and maintain a second home year-round. In a far-flung network, you might have access to some splendid vacation opportunities. Having a timeshare may force even the most dedicated workaholics to spend some time sailing or skiing. Moreover, as the timeshare promoters might say, you could be paying for tomorrow's vacations at today's prices.

Among their drawbacks, the financial benefits of timeshares are uncertain, to say the least. You'll have a substantial upfront outlay, far more than the cost of vacation lodging for a year or two. If you make a partial initial payment, the seller probably will offer financing, but the interest charges might be steep. You'll also have annual maintenance fees to pay, and perhaps some extra costs for using certain features of the plan.

Moreover, timeshares may have little or no resale value. Indeed, one strategy is to acquire a timeshare on a



growing online secondary market, for a fraction of the initial price. You'll have to pay future maintenance fees, though.

Proceed with caution

Ultimately, you should approach a timeshare as you'd evaluate any major outlay. Don't make a snap decision, especially after hearing a persuasive sales pitch. Read the contract carefully and get answers to any questions that arise. Crunch the numbers.

Example 3: In example 2, the Grants pay \$25,000 for a timeshare; each year they can use 200 points for vacations in the network. The

Grants calculate that 200 points will get them around \$3,000 worth of vacation lodging, at current rates. Assume the maintenance on this hypothetical timeshare is \$800 a year. If so, the Grants will save \$2,200 on their lodging: they'll pay \$800 maintenance instead of the \$3,000 going rate.

In such a situation, it will take more than 11 years for the annual savings to justify the upfront outlay, assuming no resale value. If there were a resale value, the numbers would be much different. Our office can help you go over the numbers in a timeshare you're considering, to help you make an informed decision. ■

TAX CALENDAR

JUNE 2016

June 15

Individuals. If you are not paying your 2016 income tax through withholding (or will not pay enough tax during the year that way), pay the second installment of your 2016 estimated tax.

If you are a U.S. citizen or resident alien living and working (or on military duty) outside the United States and Puerto Rico, file Form 1040 and pay any tax, interest, and penalties due for 2015. If you want additional time to file your return, file Form 4868 to obtain four additional months to file. Then, file Form 1040 by October 17.

Corporations. Deposit the second installment of estimated tax for 2016.

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

JULY 2016

July 15

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