

# ARMAO LLP

CERTIFIED PUBLIC ACCOUNTANTS

100 Quentin Roosevelt Boulevard, Suite 209  
Garden City, New York 11530  
516-320-7220

Email: [info@armaollp.com](mailto:info@armaollp.com) • [www.armaollp.com](http://www.armaollp.com)  
[www.facebook.com/ArmaoLLP](https://www.facebook.com/ArmaoLLP) • <https://twitter.com/armaollp>

## Client Information Bulletin

January 2016

### Watch Out for the Itemized Deductions Trap *Reduction affects high-income taxpayers*

**R**emember when you could claim itemized deductions on your tax return with no restraints? Those good old days are long gone. Under the Pease rule—named for the Ohio congressman who initially introduced the concept a quarter of a century ago—upper-income taxpayers may lose some bang from their bucks.

**How it works:** Certain itemized deductions are reduced if your adjusted gross income (AGI) exceeds an annual dollar threshold. This provision was initially included in the Omnibus Budget Reconciliation Act of 1990 before it was gradually phased out in the early 2000s. But the Pease rule was fully reinstated in 2013 and applies currently and for the foreseeable future.

Note that the Pease rule does not apply to all itemized deductions, although several “big-ticket items” are on the list. These include charitable donations, mortgage interest, state and local income taxes, property taxes and miscellaneous expenses. Conversely, the Pease rule does not cover medical expense deductions, investment interest deductions, casualty and theft deductions, or gambling loss deductions, but these deductions already have built-in limits. For instance, medical expense deductions are generally limited to the excess above 10% of your AGI on your 2015 tax return (7.5% of AGI if you are age 65 or older).

For 2015 returns, the reduction is equal to 3% of the excess above \$258,250 for single filers and \$309,900 for joint filers. (These amounts are indexed for inflation.) However, in no case can the reduction be greater than 80% of your total deductions. This limit affects only the wealthiest of taxpayers.

**Example 1:** Archie exceeds the AGI threshold by \$200,000 and has \$50,000 in annual deductions from charitable gifts, mortgage interest, and state and local taxes. As a result, the reduction is equal to 3% of the \$200,000 excess, or \$6,000. Thus, his itemized deductions of \$50,000 are scaled back to \$44,000.

**Example 2:** Betty exceeds the AGI threshold by \$1 million and has \$35,000 in annual deductions from charitable gifts, mortgage interest, and state and local taxes.

Normally, the reduction under the Pease rule would be equal to 3% of the \$1 million excess, or \$30,000, cutting back her affected deductions to only \$5,000. But this would be a reduction greater than 80%. As a result, the reduction cannot be more than \$28,000, so Betty may deduct \$7,000.

The Pease rule does not figure in the alternative minimum tax (AMT) calculation for individual taxpayers. But certain itemized deductions—including mortgage interest and

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state and local income taxes—are already disallowed under the AMT.

Another comparable tax law provision phases out the tax benefit of personal exemptions for high-income taxpayers at the same indexed thresholds as the phaseout of itemized deductions. Obtain more details from your tax advisers.

What can you do about the Pease rule? The 2015 tax year is over, but you should consider the potential impact as you move forward. For instance, you may be inclined to postpone charitable gifts to a low-tax year or accelerate deductible expenses into a year in which you anticipate being below the AGI threshold. Finally, stay on top of any new tax developments in this area.

## How to Empower Your Employees

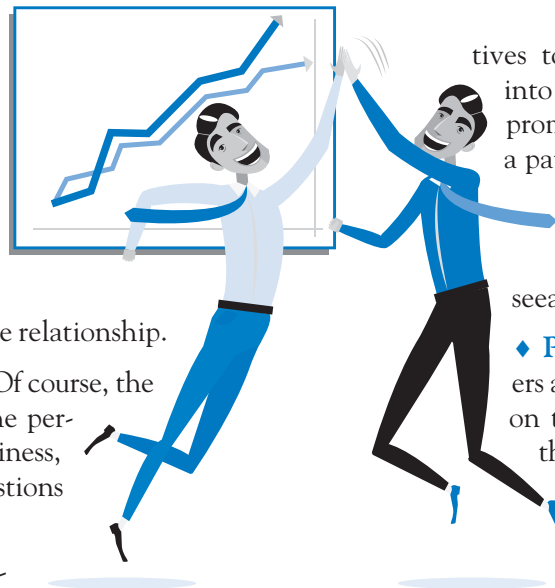
### *Allow your workers to succeed*

If you are a small-business owner, you have probably learned several important lessons over time, including the fact that you simply cannot do everything yourself. But it is not easy letting go and empowering employees to do meaningful work in your stead. It requires a high level of trust on both ends of the relationship.

What is the best way to go about it? Of course, the particulars will vary according to the personalities and the nature of the business, but here are some practical suggestions you might follow:

♦ **Share your vision.** It is difficult for employees to meet your expectations if they do not have a clear understanding of what it is you are trying to accomplish. This applies both to the overall mission of the company and to specific tasks. Realize that the methodology may not always match your own—no two people work exactly the same way all the time—but the results are what matter most.

♦ **Provide incentives.** You care deeply about your business because it is your business. Although you can expect some loyalty and dedication from employees, they do not have the same vested interests you have. With that in mind, you might offer some extra monetary incen-



tives to employees who will be stepping into your shoes. Also, you may agree to promote an employee or at least create a path to advancement within the firm.

This could be especially important to someone who sees his or her career goals blocked for the foreseeable future.

♦ **Present a challenge.** Usually, workers are hired to fulfill specific roles based on their capabilities, but after a while, they become mired in a rut. Offering them leadership and other opportunities will likely stimulate their creative juices and could result in some of their best work. More often than not, you will find that employees will rise to the challenge. Figure out how best to utilize their skillset in a new and challenging format.

♦ **Establish reasonable standards.** Employees will find it helpful if you set goals and establish a way to measure their performance. Be realistic about what you expect them to achieve. Performance does not always need to be quantified (e.g., using a grading scale), but employees will benefit from some feedback and, if needed, constructive criticism.

♦ **Get out of their way.** Finally, the worst thing you can do is hover in the background or micromanage the situation. Once you have established the basic parameters, let employees operate without any significant encumbrances. Naturally, depending on the circumstances, some restrictions may be required. But you have given them the job; now let them do it.

Empowering employees can be beneficial to the long-term growth of your firm. In addition, you can attract better talent and retain those workers if they see empowerment as part of the job. Reminder: Don't try to do it all alone.



### **Give Us A Call!**

Do you have any questions or comments about **Client Information Bulletin** or your individual situation? Please do not hesitate to contact our office. We would be glad to serve you in any way we can.

# 10 Smart Money Ideas for 2016

## *How to achieve financial success*

No one can predict with any great certainty the financial outlook for 2016, especially with the national elections looming in November. Nevertheless, here are 10 top money management moves that make sense for the rest of this year.

**1. Diversification:** If volatility in the stock market has taught us anything, it is the importance of diversification. Diversification means spreading your investments over different asset classes, as well as investing within those classes. Conversely, if your investment focus is extremely narrow, the risk of a disaster is greater.

**2. Asset allocation:** This investment principle often works hand in hand with diversification. By assigning various percentages to the assets in your portfolio, you increase the likelihood of meeting your main objectives and addressing risk aversion.

**3. Portfolio rebalancing:** Even the best investment design can skew over time. The right portfolio is a moving target that you must keep an eye on. For instance, if you have adopted an asset allocation plan, now is a good time to review it and make the necessary adjustments.

**4. Tax efficiency:** As you become more proficient at investing, you should place a greater emphasis on being tax efficient. Factor the tax ramifications into your investments. Remember: It is what you keep after taxes, not how much you earn, that really matters.

**5. Budgeting:** Spending more than you make is a common problem. It's helpful to draw up a monthly budget that takes all your expenses into account. Give yourself a little leeway—everyone is entitled to splurge occasionally—but stick close to the guidelines throughout 2016.

**6. Debt reduction:** Although some forms of debt, such as the mortgage on a house, may be perfectly accept-

able, you should do your best to reduce your other debt load, especially if you are paying interest at relatively high rates. In some cases, debt consolidation may be advisable.

### **7. Emergency funds:**

The old axiom about saving for a rainy day is true. Squeeze some extra savings out of the monthly

budget—even if you do not think it is critical.

A sudden job loss or unexpected health issue can change things in a hurry.

**8. Retirement plan contributions:** If you already contribute to an employer plan such as a 401(k), keep plugging away. In fact, where you can afford to, you might increase contributions for 2016. The money in your account continues to grow on a tax-deferred basis until it is withdrawn—usually, not until you retire.

**9. Traditional and Roth IRAs:** Qualified plan contributions may be supplemented by traditional and Roth IRAs. Because Roths offer future tax advantages, you may choose to convert IRA funds into a Roth this year and pay the resulting tax. If you converted in 2015 and want to undo it, you have until October 17, 2016, to do so.

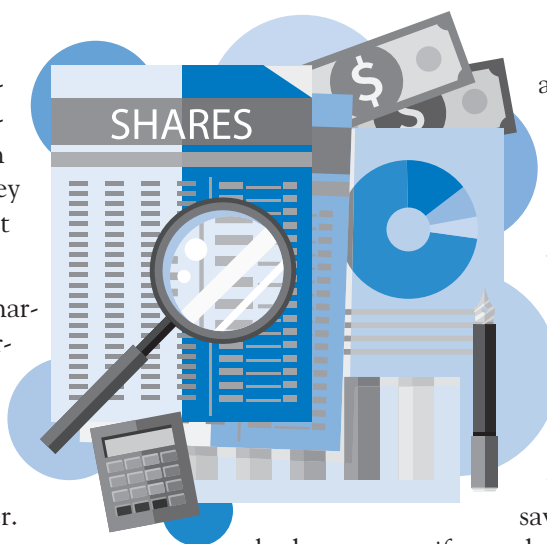
**10. Estate planning:** Finally, look forward into the future. Fine-tune your estate plan by addressing the changing needs of your family. When possible, maximize the benefits for your heirs with a minimum of tax erosion. Rely on your tax and financial advisers for assistance.

*Fortunately, you do not have to go it alone. Rely on your professional financial and tax advisers for assistance.*

## *Is It Time to Switch to “S” Status?*

Depending on your situation, it may be beneficial to switch from a C corporation form of business ownership to S corporation status. This provides taxation on an individual level, like a partnership, with no corporate tax. But the setup is not more beneficial for everyone.

Be aware that the deadline for electing S corporation status for 2016 is March 15, 2016. After that date, the election generally will not take effect until 2017.





## Seven Ways to Thwart a Data Breach

### *Plug holes in your current system*

**R**ecent high-profile data breaches, including those involving Anthem and Target, are cause for concern. Virtually every company, regardless of its size, is exposed to the potential dangers. The loss or theft of private information not only is expensive but also might harm business relationships and cause legal complications. In the worst case, the business could even go under.

Why put your company's reputation at stake and risk a financial catastrophe? Be proactive about preventing data breaches. Start by implementing procedures that should trigger a fast response in the event a breach occurs. Here are seven possibilities.

**1. Take an inventory of the private information on file, and retain only what is necessary.** As part of this process, you should shred old files, destroy old hard drives, and wipe portable devices and remove memory cards before you discard them. Limit access to employee and client records to a "need-to-know basis."

**2. Protect the integrity of the system.** Typically, this means installing and updating computer firewalls as well as antivirus and antispyware programs. Even a basic software package can be helpful, while encryption programs are becoming more affordable.

**3. Run background checks on employees.** In many cases, a significant number of employees will have access to restricted information, so be thorough. Do not allow exceptions for longtime employees who have been loyal to the company—this applies to everyone.

**4. Review agreements with outside sources.** For instance, if your company shares data with a third party, such as a payroll processing firm or some other vendor or supplier, any contract should stipulate that the third party is responsible for costs when information is breached while it is under their control.

**5. Use professional security services.** For even greater security, be proactive in this area. A security consultant can help you decide what level of protection you need and will remain "on call" at all times.

**6. Consider extra insurance.** Because data is so critical to small businesses today, you might add data breach insurance to your basic property and casualty insurance coverage. The coverage pays for responders, in addition to providing other services such as identity fraud case management for clients. Simply contact your insurance carrier to start the ball rolling.

**7. Stay calm if a breach occurs.** Take a deep breath, and then act swiftly and decisively. Analyze what level of information has been exposed, comply with state reporting laws and determine the best course of action for a response. Your business advisers may provide valuable guidance.

*Do not think that your company is immune from technological dangers. By planning ahead—and adopting some, if not all, of these seven basic security measures—you should be able to reduce your exposure and limit the potential for devastating losses. Coordinate these activities with the experts in the field.*

## Facts and Figures

### *Timely points of particular interest*

➔**Per Diem Rates**—The government recently released per diem rates for business travel in fiscal year 2016 (FY2016). Private employers may also use these rates. For FY2016, the rate for specified high-cost areas is \$275 (up \$16 from 2015), composed of \$207 for lodging and \$68 for meals and incidental expenses (M&IE). The rate for low-cost areas is \$185 (up \$13 from 2015), composed of \$128 for lodging and \$57 for M&IE.

➔**Tracking Time**—One of the keys to better time management is making lists. You cannot expect to keep everything you have to do during the day in your head. Expand this technique to include monthly and annual lists. Making lists, and referring to them, is a fundamental business practice. Now you can use technology, including cell phones and other electronic devices, to take it to the next level.

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