KELLY T. DAVIS, CPA, PA
Accountants & Advisors | Partnering for Success
12701 Metcalf Avenue | Suite 202 Overland Park, Kansas | 66213
O (913) 239-9520 | F (913) 239-9522 | LinkedIn | Website

A tax, business, and financial planning newsletter for our clients and friends

CLIENT'S tax & financial UPDATE
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How Gainsharing Can Benefit Companies & Employees

Incentives to motivate employees have been around for a long time, but few offer the flexibility and potential of what is commonly referred to as "gainsharing". Gainsharing is a program that rewards a company's workers for increased production, improved quality, cost reductions, and other achievements through the payment of regular cash bonuses. Properly conceived and implemented, a successful gainsharing program can produce significant benefits for a company.

Typically, an effective gainsharing program can increase productivity by as much as 15%. Equally important, gainsharing establishes a direct relationship between a company's performance and what it pays its employees. When business is soft, bonuses are reduced or even eliminated, but when conditions are good, the work force shares in the company's gains.

How it works

The first requirement for a successful gainsharing program is that it establishes easy-to-understand performance standards for particular work tasks. These performance standards determine whether employees in a specific job earn a cash bonus. Gainsharing bonuses are usually paid monthly because employee motivation is strongest when employees receive their bonuses as soon as possible after they've achieve their performance goals. To draw attention to the unique nature of a gainsharing bonus, it's usually paid separately from the payroll check.

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taxPOINTS

Investment deductions. Create tax savings from your investments – exchange your bonds. If you own bonds that have unrealized losses, sell them for a tax loss and replace them with similar bonds. To avoid the wash-sale rule that would make the loss non-deductible the replaced bonds may be similar, but not the same as those sold. **Example:** Bonds with the same credit rating and yield and in the same industry but a different issuer.

Contributions limit to 401(k) plans continue to increase. For 2015, the maximum employee contribution is $18,000. **Added benefit:** For those taxpayers who are age 50 or older the catch-up contribution is $6,000 for a maximum total employee contribution of $24,000.

Investment interest expense deduction. Investment interest expense, such as margin interest, is deductible, but is limited to the amount of taxable investment income that one has. Interest income and dividend income is investment income, but not tax favored capital gains. Unused investment interest expense can be carried forward to future years. **Tax strategy:** To get a deduction now for unused investment interest expense you can elect to treat a portion of tax favored capital gains and dividends as income taxed at ordinary rates,then the unused investment interest is deductible against it.

When a Home Improvement is a Medical Deduction

In general, a portion of home improvement can be a medical expense deduction if the primary purpose of the improvement is medical care such as a wheelchair ramp for a handicapped individual or an elevator for someone with a heart condition.

Determining how much of the cost of such improvements is deductible depends on whether the improvement becomes a part of the house or whether it is something that can be detached from the house. If it's detachable, the entire cost of the improvement is usually a deductible medical expense. But if the improvement becomes a part of the house, you can deduct only that portion of its cost which exceeds the increase in the value of the house because of the improvement.

For example, the cost of a room air conditioner installed on doctor's orders would be fully deductible because it is detachable and it does not increase the value of the house. However, a central air conditioner installed on doctor's orders would be deductible only to the extent that its cost exceeded the increase in the value of the house. Therefore, if the central air conditioning cost $12,000 but added $7,000 to the value of the house, only $5,000 would be a deductible medical expense.

In the case of a tenant who rents property, the entire cost of equipment installed for medical reasons would be deductible, since a tenant does not own the property and would gain nothing from an increase in its value.

When the Cost of Looking for a Job is Deductible

Under certain circumstances, you can deduct the cost of looking for a job as a miscellaneous itemized deduction up to the amount your total combined miscellaneous deductions exceed 2% of your Adjusted Gross Income. To deduct job-hunting costs, you must be looking for employment in the same or a related field of work. If you satisfy the requirements, here are some of the costs you can deduct.

- *The cost of transportation to and from job interviews.*
- *50% of the cost of meals and entertainment which you incur because of your job search.*
- *The cost of out of town travel to seek new employment, including transportation and lodging.*
- *Fees that you pay to job counselors, recruiters, and employment agencies.*
- *The cost of newspapers and other publications that you buy because of their employment advertisements.*
- *The cost of preparing and mailing resumes, including printing, envelopes and postage.*

Even if you don't find a new job, you can still claim these deductions.

Qualified Tuition Plans – 529 Plans

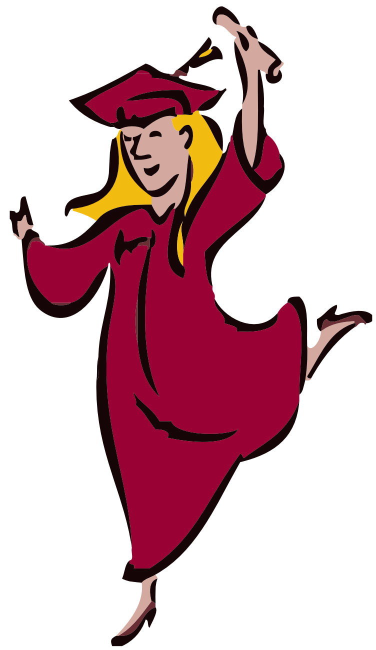
Section 529 college saving plans offer income tax, gift tax, estate tax, and asset protection benefits. But, in spite of all the hype and publicity (which they do deserve), 529s aren't for everyone.

If you're on either end of the wealth spectrum, there may be better options, which are often lost in the marketing barrage for 529 plans.While 529s may be great for most people saving for college, it depends on your specific situation…

You're on the low end of the income/wealth spectrum. You might be better off keeping the money in your name. You might need the money for yourself. From an emotional perspective, you may not want to have your child see 529 money that he/she will assume is for college only to see you pull it out to meet a family emergency. Also: Your tax bracket may not be so high that the tax advantages of a 529 account are that significant.

You're on the high end of the income/wealth spectrum. You might benefit your family more if, as part of an overall financial, asset protection, and estate planning strategy, you establish trusts for your children and grandchildren to which you can gift interests in family businesses or investments at a discount. Fractionalize ownership of family entities by these gifts, remove future appreciation from your estate, and achieve other goals. You can, at these levels, always pay for tuition costs directly and free of any gift tax.

Lesson: 529 plans, like most estate and financial techniques, are a wise choice for some people, but not for everyone. Use discretion to be sure you're taking the steps that are right for you.



A Better Way to Pay Part-Timers

Before you hire more full-time workers, consider hiring part-time employees at "peak time" wages. It's an alternative that can save you money and actually increase productivity. The key to this strategy is to determine exactly *when* you need more employees. Then pay part-timers a premium to work *just during those hours*.

For example, your shipping department may appear understaffed, but when you look into the situation, you discover that there's a flood of outgoing orders on Friday. Instead of hiring more full-time shippers at $14.00 an hour, hire part-timers at higher wages – perhaps $16.00 an hour – but just to work on Friday. The premium peak time wage will attract better workers than you could get for $14.00 an hour and you won't have to pay for many of the benefits that full time employees get.

There are other advantages to peak time pay. Some companies that use it have been able to reduce the number of full-time employees because many workers decide to switch to part-time at peak time wages. In addition, you'll be able to develop a pool of part-time workers who you can call on when you need them. And part-timers who usually job hop won't do so because peak time wages are attractively high. You might lower certain overhead costs, too.

For peak time pay to work, it's essential to make a detailed analysis of when peak workload periods actually occur.

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How Gainsharing Can Benefit Companies & Employees (continued)

It's these two aspects of gainsharing – frequent payments and a direct link to job performance – that make a gainsharing plan different from a profit-sharing plan. In most profit-sharing plans, workers don't receive benefits until retirement, and the company's annual contribution to a profit-sharing plan is often taken for granted as an automatic donation rather than a personal reward for good work.

Setting performance standards

The formula used to determine a gainsharing bonus must be acceptable and equitable to both the company and its employees. The best way to achieve this is to base the formula on a reporting system that has proven itself to be reliable. Two major standards must be set:

1. The size of the bonus, which can be established in several ways – for example, the ratio of labor costs to sales.

2. Justification of the bonus as a true reflection of the company's improved performance – for example, production units per hour.

Bonus performance standards should be based on the company's reasons for adopting a gainsharing plan. Typical standards involve ratios between various factors such as production value, cost of quality, units of output, labor hours, and cost of goods. Improvements in any of these areas should be measurably beneficial to the company's performance.

It's important not to build too many standards into a plan because a plan must be easy to understand so that employees will respond to it. Standards must be chosen carefully so that bonuses are paid only if the company benefits financially when its employees meet the standards.

Getting the most out of gainsharing

- Gainsharing works best in companies that have fewer than 100 employees. Although it can also work in larger companies, gainsharing is more difficult to administer and implement in larger companies.
- A gainsharing plan is more effective if it begins at a time of the year when a company is traditionally busy. This permits employees to achieve results and earn gainsharing bonuses right at the beginning of the plan.
- Gainsharing will work best in a freestanding facility where the production mix is not too broad.
- Management should design a gainsharing program so that while both the company and its employees benefit, higher productivity does not result in layoffs.
- Gainsharing plans should not be used in companies where employee relations are poor, where operations are highly automatic, where departments work independently of one another, or where certain workers in a particular department won't be included in the program.

Use Your Home for Business? Avoid Extra Taxes When You Sell

When you sell your principal residence, you can exclude from income up to $250,000 of gain and $500,000 on a joint return. Ownership and use tests must be met. But if you've been taking a home-office deduction because you used part of your home for business, the IRS will consider part of the house sale as a sale of business property. That means you'll have to pay taxes on the portion of the gain which is allocated to the part of the house you used for business.

You can avoid this problem if no part of your house qualifies for a home-office deduction during the year the sale is made. If you make sure that it's obvious that your home office space is used for non-business purposes, it won't qualify for the home-office deduction. The sale will not be treated as a partial sale of business property and 100% of the sales proceeds will qualify for deferral of taxes on the gain.