Tax Q&A: How to avoid penalties on estimated taxes

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Still need to do your taxes? USA TODAY readers submitted tax questions, and here are the answers from members of the American Institute of Certified Public Accountants (http://www.aicpa.org/).

Today's question:

Q. For 2012 I reported owing the IRS $708. My concern is the possibility that I will owe more than $1,000 at the end of 2013. But the unreliable nature of the income I'm paying taxes on makes any estimate very unreliable. My main concern is I don't want to get hit with future IRS penalties because of what amount I might owe at the end of a year.

A. The easiest way to prevent IRS penalties for underpayment is to pay estimated taxes equal to 100% of your prior year's taxes (or 110% of your prior year's taxes if your prior year's adjusted gross income was more than $150,000, $75,00 if your status was married filing separately). This will allow you to satisfy the "safe harbor" requirement, and you won't have to pay penalties even if you actually end up owing more than your estimated tax payments. It's also a simple way to determine your estimated taxes. IRS Publication 17 Section 4 gives all the details of estimated tax.

Clare Levison, CPA, Blacksburg, Va.

Q: I purchased a condo in Florida for my in-laws so they could be near us in case they needed help. I paid $120,000 cash for it in 2005, and we never charged them rent. They have since passed. We were unable to sell it, due to the economy, until last month. We sold it for $53,000. Are we able to take a loss on our taxes?

A: In order to deduct the loss, the property would have to have been held out as rental property. Can you document that you tried to rent the property? Under the description you provide, it appears more like a second home that you let your parents live in. Sorry, this is not deductible.

Michael E. Goodman, CPA

Wealthstream Advisors, New York City

PREVIOUS QUESTIONS

Q: How do I calculate my basis for an IRA I converted to a Roth IRA?

A: The conversion of a traditional IRA to a Roth IRA is taxed the same as if you'd taken a qualified distribution from the traditional IRA. If all your contributions and earnings were pretax, all that you convert is taxed as ordinary income.

However, if you have ever made non-deductible contributions to any of your IRA accounts, then you will need to calculate the portion of each future distribution that is attributable to basis. This calculation is made for the total of all IRA accounts that you own. You can't pick and choose specific IRA accounts.

Example: Mary owns a single traditional IRA for which she has contributed $6,000 pretax and $2,000 post-tax. Mary converted $1,000 of her traditional IRA to a Roth IRA during 2012. At the end of 2012 the value of Mary's IRA was $9,000. Mary's basis is $2,000, so the non-taxable portion of the conversion would be $200 (2,000/10,000 x$1,000). The remaining $800 of the conversion would be taxed as ordinary income. Mary's beginning basis for any future distributions/conversions becomes $1,800. For more information:

Publication 590: Individual Retirement Arrangements (http://www.irs.gov/pub/irs-pdf/p590.pdf)

Terry L. Seaton, CPA
Seaton Financial Advisors, St. Augustine, Fla.

Q. I won a free cruise in 2011, which I took in 2012. I understand I should receive a 1099 for the cruise, but I can't get the cruise line to send me the 1099. What if I don't have the 1099 by next month? How do I file my taxes with that taxable freebie paperwork?

Also, when I originally won the cruise I inquired about what the 1099 amount might be – my "cruise director" indicated about $2000 – which is several hundred dollars more than a comparable room on the cruise if I just paid upfront. Plus the room had a lifeboat hanging over the

window, so we didn't even get a room with a view, which is how the rooms are priced. If I want to dispute the value of the 1099 (if I ever see it), how do I do this with the IRS and still get my taxes resolved on time?

A: Assuming the cruise line is the organization that offered the free cruise promotion and not someone else, they are required to issue a 1099 to you and send a copy to the IRS by Feb. 28. The 1099 should be for the actual value of the benefit you received. That could be subject to interpretation as it will probably be reported as the "brochure" price for the type of room you had, as opposed to any discounted price you may have received if you paid for the cruise. If you don't get the 1099 by the time the return is due, you will have to file for an extension and use your best estimate as to the value of the cruise to determine your tax liability. Not sure you will get anywhere with the IRS as it is the cruise's responsibility to determine the value. Hope this helps.

Ken Rubin, CPA,
RubinBrown, St. Louis

Q. My husband and I refinanced our home in November and paid close to $10,000 in closing costs. Is any of that deductible? I never received a tax form, just our HUD settlement statement. Please help as we don't want to lose out on any deductions.

A: There are several items on a closing statement from the refinancing of a residence that may be deductible.

Often, interest expenses for the period between refinancing and the first mortgage payment are included on the closing statement. These should be reported on the Form 1098 (http://www.irs.gov/pub/irs-pdf/f1098.pdf) you received from the lender but it is always a good idea to double-check.

TAX TIPS: Seven ways for homeowners to save (/story/money/personalfinance/2013/03/05/tax-tips-homeowners-irs-deduction/1964555/)

The refinance statement may also include mortgage points. On a refinance, points are deductible over the term of the loan.

The statement may also include real estate taxes, which may be deductible.

Normally all other costs are added to the basis of the residence, which can help when you sell the house.

Teri E. Newman, CPA,
Plante Moran, Chicago

For more information:

Publication 530: Tax information for homeowners (http://www.irs.gov/pub/irs-pdf/p530.pdf)

Publication 936: Home mortgage interest deduction (http://www.irs.gov/pub/irs-pdf/p936.pdf)

Publication 523: Selling your home (http://www.irs.gov/pub/irs-pdf/p523.pdf)

Q: I'm a 14-year-old boy, and through my website and Amazon.com selling business I have taken in a fair amount of money in the last year—but I have never payed taxes and don't know how. Is there something I should do specifically since I'm under 18?

A: Generally, a dependent child must file a return if any of the following apply:

• Unearned income (such as interest and dividends) over $950

• Earned income (such as salaries and self-employment) over $5,950

• Gross income (earned plus unearned) more than the greater of (1) $950 or (2) earned income plus $300 (not to exceed $5,950).

A 14-year-old is normally still a dependent of their parents. An Internet sales business would be earned income for the 14-year-old. He should consider filing a Schedule C, Profit or Loss from Business, as part of his Form 1040, Individual Income Tax Return.

His earned income would equal his gross sales less his expenses, if any. Some possible expenses may include his cost of advertising and any fees paid to Amazon. If his earned income is greater than $5,950, he is required to file a tax return.

He may also be required to file a Sales and Use Tax Return. He should check with his State Department of Revenue.

S. Miguel Reyna, CPA

Reyna CPAs, Dallas

For more information:

Do I need to file a return? (http://www.irs.gov/uac/Do-I-Need-to-File-a-Tax-Return%3F)

Publication 929: Tax Rules for Children and Dependents (http://www.irs.gov/pub/irs-pdf/p929.pdf)

Q: Can I roll over a Roth IRA to a Roth 401(k)? If I can't, am I able to withdraw my Roth IRA funds without penalty or income tax on earnings if I use it for a down payment on a first-time home?

A: A Roth IRA can only be rolled over to another Roth IRA (http://www.irs.gov/pub/irs-tege/rollover_chart.pdf) and is not permitted to be rolled over or transferred to a Roth 401(k).

First, withdrawals from a Roth account up to the amount of account owner contributions are not taxed and are not subject to the 10% penalty regardless of your age or how long you've owned the account. Any withdrawals that exceed the owner's contributions are subject to taxation and a 10% penalty unless they are qualified distributions.

For a withdrawal to be qualified two tests must be met:

• The owner must be 59 1/2 or older, or an exception applies – and the first-time home purchase is an exception.

• Five-year test: Owner must have owned the account (or any other Roth account) for at least five years

Since you are using the withdrawn funds for a first time home purchase, you pass the first test. ;Therefore, if you also pass the five-year test, the withdrawal would be "qualified" and you would not be assessed taxes or penalties.

However, if you fail the 5-year test, you would owe ordinary income taxes on the earnings portion of the withdrawal but the 10% penalty would be waived (up to a maximum of $10,000 of earnings withdrawn).

Terry L. Seaton CPA
Seaton Financial Advisors, St Augustine, Fla.

For more information:

Chart: Types of allowable rollover transactons (http://www.irs.gov/pub/irs-tege/rollover_chart.pdf)

Tax Topic: Rollovers of retirement plan distributions (http://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Retirement-Topics---Rollovers-of-Retirement-Plan-Distributions)

Differences between a Roth IRA and designated Roth account (http://www.irs.gov/pub/irs-tege/roth_differences.pdf)

Q: Are costs from an auto accident that was ruled not my fault deductible? The offending party and/or his insurance company has not paid for medical costs due to the lack of insurance or ability to pay. I have over $20,000 dollars which I paid in 2012. Thanks

A: The Internal Revenue Code does provide for a deduction for medical expenses (http://www.irs.gov/uac/Newsroom/Seven-Important-Tax-Facts-about-Medical-and-Dental-Expenses) including costs associated with an accident like yours. Sorry to hear that you had an auto accident with injuries that required medical attention. You can deduct all of your medical expenses incurred during a tax year that exceed 7.5% of your adjusted gross income if you are itemizing.

For example, let's say that your adjusted gross income for the year is $80,000. That would mean the threshold for you to have the benefit of deducting your medical expenses would be $6,000, ($80,000 x 0.075). So the first $6,000 of your $20,000 of expenses would not be deductible, but the remaining $14,000 would.

Added to these costs could be other medical expenses such as co-pays, dental, optical, prescriptions, physical therapy and most other health-related costs. You would add the deductible medical expenses to your other itemized deductions such as mortgage insurance, real estate taxes, state and local income taxes, and charities to determine the total itemized deductions that you would claim.

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For more information:

Publication 502: Medical and Dental expenses (http://www.irs.gov/pub/irs-pdf/p502.pdf)

Medical and Dental expenses: What can I deduct and what can't I deduct (http://www.irs.gov/taxtopics/tc502.html)

Q: I am a graduate student in literature. I know that I can deduct school fees and course materials. What I am not sure is if I can deduct books (and other items such as relevant electronics like laptops) that are not specifically assigned for a class but will benefit me in my academic pursuits, which I equate with my career as I intend to teach and research on a college level.

A: The treatment of higher-education expenses on your income tax return is one of the most complex areas of the tax law. There are several deductions and credits that may be available and typically, only one can be claimed at a time.

You should review IRS Publication 970 (http://www.irs.gov/pub/irs-pdf/p970.pdf) to determine whether the Lifetime Learning Credit (http://www.irs.gov/publications/p970/ch03.html), tuition and fees deduction (http://www.irs.gov/publications/p970/ch06.html), or some other provision applies to you.

TAX TIPS: Get the latest tax news and advice (/topic/ca4827db-f722-48dc-a3da-4a3acfa03867/tax-news-and-advice/)

If you are claimed as a dependent by your parents, you must also determine who can claim the deduction or credit. Also see Form 8917 (http://www.irs.gov/pub/irs-pdf/f8917.pdf).

The qualifying expenses are generally limited to tuition and related expenses that are required to be paid to the university as a condition of enrollment. See the examples on page 34 of Publication 970 (http://www.irs.gov/publications/p970/ch06.html#en_US_2012_publink1000295037) to see how strict these rules are.

Optional expenditures, even though helpful for your studies, such as a computer, generally are not deductible.

Annette Nellen, CPA
San Jose State University, San Jose, Calif.

For more information:

Overview: Tax benefits for education: Credits, Deductions, Savings Plans, Scholarships (http://www.irs.gov/uac/Tax-Benefits-for-Education:-Information-Center)

Publication 970: Tax benefits for Education (http://www.irs.gov/pub/irs-pdf/p970.pdf)

Q: My son, 24, and daughter, 22, have full-time jobs and still live with me. Can I claim them as dependents, or does it depend on their income?

A: To claim a child as a dependent, the child must be under the age of 19, a student under the age of 24, or permanently and totally disabled regardless of age.

In addition, the child must have lived with you for more than half the year and cannot have provided more than half of his or her own support during the year.

It sounds like your children do not qualify based on the age test.

The Qualifying Child section (http://www.irs.gov/publications/p501/ar02.html#en_US_2012_publink1000220886) of IRS Publication 501 (http://www.irs.gov/pub/irs-pdf/p501.pdf) gives all the details of the requirements (http://www.irs.gov/publications/p501/ar02.html#en_US_2012_publink1000220886) that must be met in order to claim a child as a dependent.

Clare Levison, CPA
Blacksburg, Va.

For more information:

Who can I claim as a dependent? (http://www.irs.gov/uac/Who-Can-I-Claim-as-a-Dependent%3F)

Six important facts about dependents and exemptions (http://www.irs.gov/uac/Six-Important-Facts-about-Dependents-and-Exemptions-1)

Top frequently asked questions for filing requirements, status, dependents, exemptions (http://www.irs.gov/Help-&-Resources/Tools-&-FAQs/FAQs-

for-Individuals/Frequently-Asked-Tax-Questions-&-Answers/Filing-Requirements,-Status,-Dependents,-Exemptions)

Q: I have closed one IRA account and rolled it over to another account. I received a Form 1099-R (http://www.irs.gov/pub/irs-pdf/f1099r_12.pdf), which is showing in box 2a the full amount taxable. How can I handle this?

A: I am assuming that your new IRA is also a traditional IRA and that you didn't instead roll over to a Roth IRA. If you did change to a Roth, then the full amount is taxable as Box 2a declares.

If your new IRA is a traditional IRA, then as long as you deposited the rollover proceeds from your old account into your new account within 60 days of receiving it, you will not have to pay taxes on the amount shown in box 2a.

You should have received a Form 5498 (http://www.irs.gov/pub/irs-pdf/f5498_12.pdf) from your new IRA account provider showing that you deposited the proceeds into an IRA there. Keep this form with your other tax information.

Here's how to handle it on your tax return: Report the amount listed in box 1 of Form 1099-R (http://www.irs.gov/pub/irs-pdf/f1099r_12.pdf) on line 15a of Form 1040 (http://www.irs.gov/pub/irs-pdf/f1040.pdf), or line 11a of Form 1040A (http://www.irs.gov/pub/irs-pdf/f1040a.pdf). On line 15b or 11b of the correct form, put a zero and write the word "rollover" next to line 15b or 11b. That should take care of it.

Kelley Long, CPA
Shepard Schwartz & Harris, Chicago

For more information:

IRS Publication 590: Individual Retirement Arrangements (IRAs) (http://www.irs.gov/pub/irs-pdf/p590.pdf)

Chart: Types of allowable rollover transactions (http://www.irs.gov/pub/irs-tege/rollover_chart.pdf)

Tax Topic: Rollovers of retirement plan distributions (http://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Retirement-Topics---Rollovers-of-Retirement-Plan-Distributions)

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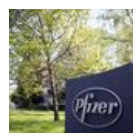
Kevin McCoy



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Kevin McCoy

(http://onpolitics.usatoday.com/2014/05/01/irs-employees-not-paying-their-taxes/)

[Congressman: No more bonuses for IRS tax delinquents](http://onpolitics.usatoday.com/2014/05/01/irs-employees-not-paying-their-taxes/)

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Gregory Korte

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