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Tax-advantaged health care payment options: HSAs and HRAs

If you're not yet familiar with the acronyms HSA and HRA, chances are you soon will be. Health Savings Accounts and Health Reimbursement Arrangements are growing in popularity because they're seen as cost-effective ways to fund health care expenses. In fact, the total number of these plans hit 5.7 million in 2010, nearly five times the number just four years earlier, according to the Employee Benefit Research Institute.

HSAs

HSAs are tax-exempt accounts set up with a qualified trustee, such as a bank or insurance company, to pay for or reimburse qualified medical expenses. To qualify for an HSA, you need to be covered by a high deductible health plan (HDHP). For 2011, a plan is considered an HDHP if:

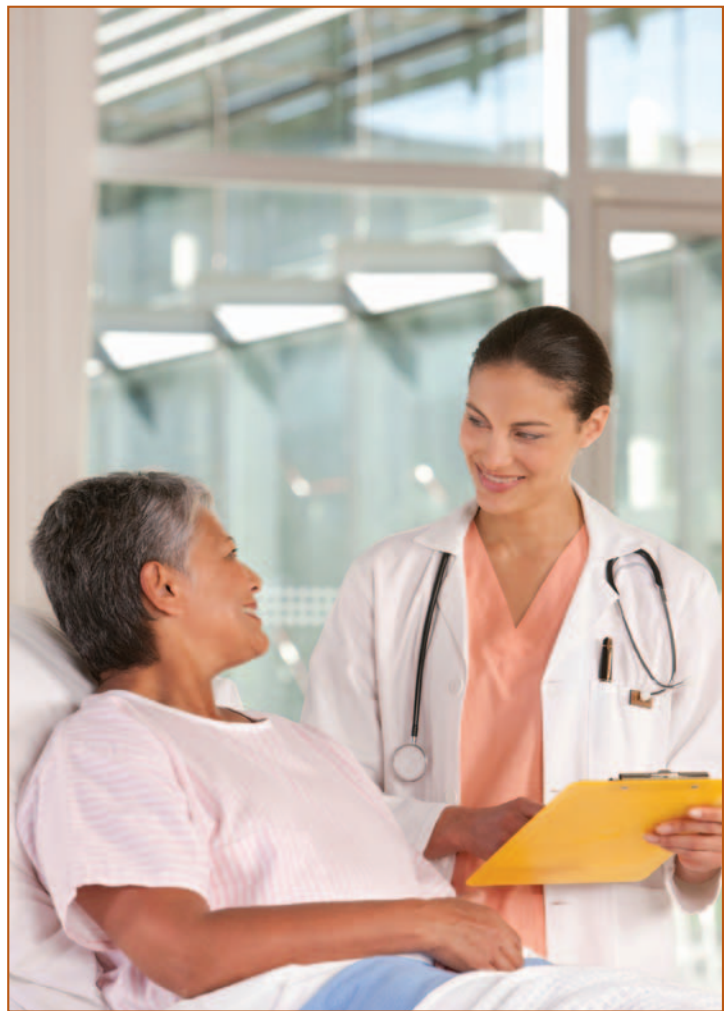
- ◆ It has a deductible of not less than \$1,200 for an individual or \$2,400 for a family, and
- ◆ Out-of-pocket expenses are limited to \$5,950 for individual coverage and \$11,900 for family coverage.

Employers can offer their employees the ability to set up HSAs, and both you and your employer can contribute to your account. These contributions will be pretax. Alternatively, you can set up your own HSA directly with a qualified trustee and deduct your contributions. Perhaps the most unique feature is that, under both scenarios, the HSA can bear interest or otherwise be invested, and earnings accumulate tax-deferred, similar to an IRA.

Your total contributions can't exceed the annual contribution limit. For 2011,

the limit is \$3,050 for individual HSAs and \$6,150 for family coverage. For 2012, the limits are \$3,100 and \$6,250, respectively. If you're age 55 or older, you can add an extra \$1,000. Contributions must be in cash; thus, you may not contribute stocks or property.

Another attractive feature of an HSA is that the funds can remain in your account until you need them. That means you don't have to worry about forfeiting your money if you



Benefits and drawbacks of FSAs

Yet one more acronym in the alphabet soup of health care plans is the FSA, or Flexible Spending Account. This plan type is established by employers and, like HSAs and HRAs (see main article), offers employees an option to pay for qualifying health care costs with pretax dollars. (If you have an HSA, your FSA is limited to funding certain “permitted” expenses.)

A high-deductible health plan isn’t required, and both you and your employer can contribute. Your contributions are made pretax directly from your pay, and any contributions from your employer also aren’t included in your taxable income.

For many taxpayers, an FSA’s biggest drawback is that any balances in their accounts not used by the end of the plan year typically are forfeited — although employers can provide a grace period of up to 2½ months. So, before making contributions, you’ll want to carefully estimate just how much you’re likely to spend over the course of the plan year. Otherwise, you could end up losing some of the money in your account.

don’t use it by the end of the plan year, as happens with some other plans. (See “Benefits and drawbacks of FSAs” above.) HSAs also are portable, so you can take the funds with you if you change employers or retire.

One of the most attractive features of an HSA is that the funds can remain in your account until you need them.

After establishing an HSA, you can take tax-free distributions from the account to cover qualified health care expenses that you, your spouse or your dependents incur. Be sure to check with your tax advisor for a complete list of qualified health care expenses — if you use HSA funds for something other than a qualified expense, the distribution will be subject to ordinary income tax plus an additional 20% tax, which essentially acts as a penalty for making an “early” nonqualified withdrawal. The 20% “penalty” doesn’t apply after the account holder turns age 65 or in certain other circumstances.

HRAs

HRAs are employer-sponsored programs that, as their name suggests, reimburse employees for qualified claims for medical expenses.

Even though an HRA may seem similar to an HSA, there are differences between the two plans. For one thing, only your employer can contribute to your HRA — you can’t contribute, and self-employed individuals aren’t eligible. Also, an HDHP isn’t required.

But, as with an HSA, you don’t have to pay taxes on your employer’s contributions, and you can receive tax-free reimbursements for qualified medical expenses that you, your spouse or your dependents incur. In addition, any unused balance at the end of a plan year can be carried forward.

Check with your tax advisor to learn which expenses qualify for reimbursement under an HRA. It’s important to note that your employer can restrict coverage to a subset of those expenses.

Reining in health care costs

Keep in mind that you can’t receive HSA or HRA reimbursements for expenses that are paid for by other coverage, such as group health insurance. Nevertheless, as out-of-pocket health care costs continue to rise, these plans can help rein them in. ♦

Under new management (style)

Transform a micromanager into a productive manager

There are myriad management styles, and the right one for your family business depends on several factors, including the number of employees and the complexity of your organization. One style that employees particularly loathe, and can be detrimental to a company, is “micromanager.”

A micromanager typically overmanages, and thus can slow productivity and lower employee morale.

Micromanager’s traits

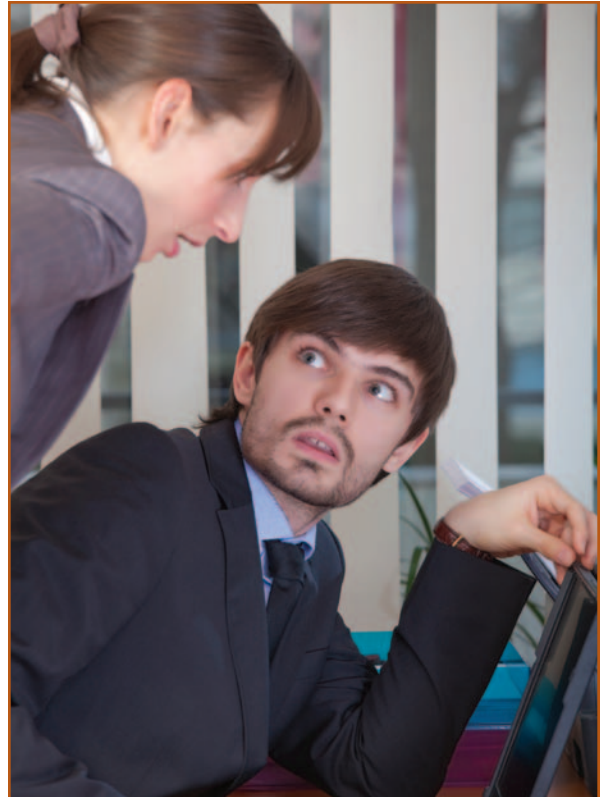
Because their traits can resemble those of hardworking and committed employees, micromanagers might go undetected for some time. Taking on extra tasks, being involved in all aspects of the department’s work and providing detailed instructions are typically favorable qualities. So how do you distinguish between these two vastly different types of staff members?

The key difference is that micromanagers tend to take over assignments by providing overly detailed instructions. In addition, if they aren’t working directly on a project, they want to be consulted on and approve every decision as well as require constant check-ins and status reports.

Because micromanagers typically question workers’ actions or differing work styles, employees can become frustrated — this can stifle their efforts and cause them to question their effectiveness or even their desire to work for the company.

Reverse negative behavior

Once you discover a micromanager, you must confront that employee about the matter yet also show support. After all, this information may be difficult to hear, because most micromanagers think that their actions are appropriate. It can be even harder for family



members, who may believe that, because of their strong personal and financial ties to the business, they’re acting in the company’s best interest.

Although micromanagers can be destructive to a business, you can reverse the damage if you address the problem right away. Begin by understanding why they act as they do. Some micromanagers believe that only they can get the job done right, or they have difficulty seeing their staff as competent members of the same team working toward a common goal. Others are insecure about their positions or overwhelmed by pressure. Still others are simply “wired” to take charge or get a rush from the power and authority of being in control. Whatever the reason, it’s important that

you and the manager identify the root cause to help develop the right solution.

Next, provide internal and external formal training. This can be in the form of participating in a mentoring program with a company leader or management effectiveness workshops. Point out to the micromanager that minor mistakes will be made and the company won't fail. Also, explain that these mistakes are learning opportunities for both the manager and the employee.

If micromanagers aren't working directly on a project, they want to be consulted on and approve every decision.

If you possess strong leadership traits, it may be worth your time to take the manager under your wing and teach him or her personally. Offer leadership tips such as taking time at a project's outset to discuss and clarify

desired outcomes, and use weekly meetings to get updates.

Finally, make sure to follow up on the issue. Request feedback from both the manager and his or her team on how well the strategies are working. And keep the lines of communication open with the manager to ensure he or she has the necessary support.

When micromanagement is in order

In instances where customers aren't satisfied, projects are headed in the wrong direction, or an employee is unwilling or unable to perform to expectations, a manager may need to *temporarily* transform him- or herself into a micromanager to resolve the problem. It's only when a manager's input is excessive or unnecessary that he or she may be a bona fide micromanager.

Don't let a manager be an anchor

For your family business to run on all cylinders, it's important for your management team to clearly communicate expectations and then let employees get to work. Having a micromanager on the team can be a drag on morale and productivity. Taking the time and resources to change a micromanager's behavior may ultimately benefit your company and its bottom line. ♦

An audit survival guide

Timeliness and preparedness can make a difference

One word that can make taxpayers cringe is "audit." Fortunately, chances are slim that you'll experience an audit: In 2010, the IRS audited just over 1% of returns. However, certain triggers can boost the likelihood that your return is among those targeted.

Red flags

There are several red flags that can trigger an audit. Your return may be selected because the IRS received information from a third party — say, the W-2 submitted by your employer — that differs from the information reported on your return.



Nearly three-quarters of audits are *correspondence* audits and are completed via mail. The IRS may ask for documentation on, for instance, your income or your purchase or sale of a piece of real estate. (Be aware that the IRS won't contact you via e-mail for an initial appointment. Contact related to being selected for an audit will be made via telephone or mail only, according to the IRS.)

In-person audits may take place at an IRS office, your home or place of business, or at the offices of your CPA, attorney or tax preparer. If the proposed time and date are inconvenient, you can ask to reschedule. But

In addition, the IRS scores all returns through its Discriminant Inventory Function System (DIF). A higher DIF score may increase your audit chances. While the formula for determining a DIF score is a well-guarded IRS secret, it's generally understood that certain things are more likely to increase the likelihood of an audit, such as a traditionally cash-oriented business, tax shelters or a home office deduction.

Bear in mind, though, that no single item listed will cause an audit. Indeed, a relatively low percentage of returns are examined. One of the biggest factors in determining the likelihood of an audit, in fact, is your income. For instance, according to IRS statistics, if your adjusted gross income topped \$1 million, your return had an 8.4% chance of being audited in 2010.

Finally, some returns are chosen as part of the IRS's National Research Program. Through this program, the IRS studies returns to improve and update its audit selection techniques.

The audit process

Should your return be chosen for an audit, it helps to know what to expect and implement a few steps that can smooth the process.

the IRS has final say over when, where and how the exam will take place.

If you receive an audit notice, read it carefully. Most will indicate the items to be examined, as well as a deadline for responding. A timely response conveys that you're organized, and thus less likely to overlook important details. It also indicates that you didn't need to spend time pulling together a story.

Should your return be chosen for an audit, it helps to know what to expect and implement a few steps that can smooth the process.

Before responding to the notice, however, confer with your CPA or tax professional. He or she can calm any jitters and help you prepare your response. If the exam will take place in person, he or she can accompany you — or even appear in your place if you provide authorization.

If you're going to meet in person, ask what documents the auditor is expecting, and what

questions will be discussed. Of course, you'll want to prepare this information and bring copies (not originals) of all that's requested. You generally don't want to bring more to an audit than what's been requested, as it may prompt more questions. If an auditor asks about something that you didn't prepare for, simply say that you'll follow up.

Similarly, answer any questions honestly, but don't volunteer extraneous information that might lead to more inquiries. Talking about a recent, lavish vacation, for example, could suggest that your income is higher than it

actually may be. Respond with "yes" or "no," providing a brief explanation where necessary.

Finally, mind your manners by being polite. While you don't need to become friends with the auditor, a cordial relationship can help the process go more smoothly.

Ease the process

Being organized, timely and professional can reduce the stress of an audit. In addition, bringing in your CPA can mean spending less in the long run, as he or she can help you navigate the process. ♦

Financing college tuition with a 529 plan

It's back-to-school time, and as Jane shops for school supplies with her young children, she begins thinking about how she's going to pay for their college education. The recession negatively affected her investments, so the funds she earmarked for college aren't as plentiful as they once were.

An attractive college-savings option that has weathered the recession relatively well is the 529 plan. In fact, at the end of 2010, the average 529 plan account balance grew to \$15,492, an 18% increase from 2009, according to the College Savings Plans Network (CSPN), a group representing the interests of member states and the 529 plans they administer.

Jane has two 529 plan flavors to choose from. The first option is a prepaid tuition plan which, as its name suggests, allows Jane to prepay all or part of her children's tuition costs at today's rates. This plan may be offered by states or private educational institutions. In 2010, assets in prepaid tuition plans grew 12%, from \$17.2 billion to \$19.2 billion, according to CSPN.

The plan — regardless of whether it's state- or privately run — is flexible in that, if Jane's children choose a different school, she can transfer her prepayment from one school to another. However, doing so may incur a penalty that's equal to a percentage of the tuition's value.

The second option is a college savings plan, which can provide for more than tuition. Tax-free distributions can also be used to cover room and board, books, and certain other higher education expenses. In 2010, assets in college savings plans increased 19%, from \$116.2 billion to \$138.2 billion, according to CSPN.

Jane can choose from different investment options, such as stocks, bonds and mutual funds, in which the plan will then invest on her behalf. The account's value is contingent on the performance of the chosen investments.

