



# Client advisor

CURRENT INFORMATION, NEWS AND TRENDS

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## New Jobs Act Brings Tax Relief to Small Business Owners

The 2010 Small Business Jobs Act enacted on September 27, 2010 includes an assortment of incentives and tax breaks for small businesses. The following is a brief overview of some of the key provisions included in the new law. Watch for additional details in future newsletters.

**Cell Phones Are No Longer Listed Property** – This means that cell phones can be deducted or depreciated like other business property, without the complicated recordkeeping required for listed property. This is effective for tax years beginning after December 31, 2009.

**Business Owners' Health Insurance Deduction Reduces Self-Employment Tax** – The new law allows business owners to deduct the cost of health insurance incurred in 2010 for themselves and their family members in calculating their 2010 self-employment tax.

**Boosted Deduction for Start-Up Expenditures** – For 2010, businesses can deduct up to \$10,000 (previously \$5,000) in trade or business start-up expenditures. However, the \$10,000 limit is reduced by the amount by which start-up expenditures exceed \$60,000 (previously \$50,000).

**Increased Small Business Section 179 Expensing** – Small business taxpayers can elect to write off the cost of certain capital expenses in the year of acquisition in lieu of recovering these costs over a period of years through depreciation.

For tax years beginning in 2010 and 2011, the new law allows a taxpayer to expense up to \$500,000 (up from \$250,000 under prior law) of qualifying property, which includes machinery, equipment, and certain software placed in service during the year. For 2010 and 2011, the annual expensing limit is reduced by the cost of qualifying property that is placed into service during the year that exceeds a \$2 million investment limit (previously \$800,000).

**Certain Real Property Can Be Expensed** – The new law also makes certain real property eligible for Sec. 179 expensing. For property placed in service in any tax year beginning in 2010 or 2011, the up-to-\$500,000 deduction of property expensed can include up to \$250,000 of qualified real property (qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property).

**50% Bonus First-Year Depreciation Extended** – Businesses normally can only deduct the cost of capital expenditures over time through depreciation – most commonly at the rate of about 14% or 20% of the cost of machinery or equipment for the first year. For 2008 and 2009, businesses were permitted to write off 50% of the cost of new machinery and equipment placed in service during those years. In the new law, Congress extends the first-year 50% write-off to qualifying property placed in service in 2010 (2011 for certain properties).

**General Business Credits for 2010 Can Be Carried Back Five Years** – Under the new law, for the first tax year beginning in 2010 (2010 for calendar-year taxpayers), eligible small businesses (ESB) (generally one with \$50 million or less in average annual gross receipts for the prior three years) can carry back unused general business credits for five years. ESBs include sole proprietorships, partnerships, and non-publicly traded corporations.

**General Business Credits of Eligible Small Businesses in 2010 Are Not Subject to Alternative Minimum Tax (AMT)** – Under the AMT rules, taxpayers generally can claim only allowable general business credits against their regular tax liability and only to the extent that their regular tax liability exceeds their AMT liability. A few credits, such as the credit for small business employee health insurance expenses, can be used to offset AMT liability. The new law allows eligible small businesses, as defined above, to use all types of general business credits to offset their AMT in tax years beginning in 2010.

**Other Provisions with Limited Application** – Calculations of the built-in gains tax on S-Corporations converted to C-Corporations, special rules for long-term contract accounting, and limitation on the penalty for failure to disclose certain reportable transactions (including listed transactions) on a return.

If you have questions related to any of these new tax benefits or wish to schedule a tax planning appointment to see how your business might benefit, please give this office a call.





# The Year-End Challenge: Is Your Tax Deduction List Ready?

As the end of the year approaches, it's a good time to review your potential tax deductions and develop a strategy that maximizes the benefits. Most taxpayers may deduct the higher of two amounts from adjusted gross income when figuring their taxable income. These amounts are either a fixed amount set by law (the "standard deduction") or a listing of the expenses the taxpayer paid during the year that the government allows (known as "itemized deductions").

The basic federal standard deductions for 2010 are: \$11,400 for joint filers, \$8,400 for head of household, and \$5,700 for others. Add-ons to the standard deduction are allowed for taxpayers (and their spouses, if filing jointly) who are blind and/or age 65 or older. In some years, other add-ons – such as a limited amount of real property tax – are also allowed.

It would seem like a simple choice – use the larger of the standard or itemized deductions. However, strategies may be used to maximize the benefits that add complexity. For example:

- **Bunching Strategy** – If your itemized deductions and your standard deduction are about the same, it may be possible to maximize your itemized deductions every other year and take the standard deduction in alternate years. Methods of doing this are discussed below.
- **The Alternative Minimum Tax (AMT) Effect** – If you are subject to the AMT, the standard deduction is not allowed at all, but some itemized deductions are. Therefore, if you are subject to the AMT, you should always itemize your deductions.

Here are some tips on maximizing your itemized deductions:

- **Medical** – Medical deductions for regular tax purposes are deductible only to the extent that they exceed 7.5% of your Adjusted Gross Income (AGI). That percentage increases to 10% for the AMT. Where possible, consider prepaying or deferring medical expenses to match your deduction strategy. In addition to the normal medical deductions, don't overlook the costs of fertility procedures, learning disability expenses, nursing home expenses, pregnancy tests, certain special education, prescribed smoking-cessation programs, certain weight-loss program expenses, and certain impairment-related expenses.

A child's medical expenses paid for by divorced parents are generally deductible by the parent who pays the expense. You can also deduct medical expenses for an adult "medical dependent." Generally, one who would qualify as your dependent except for gross income limitations.

- **Taxes** – Deductible taxes include real and personal property taxes as well as state and local income taxes. Generally, real property taxes are paid in two or more installments during the year. This gives you the opportunity to "bunch" tax payments by paying an entire year's tax bill plus one or more installments from the prior year all in one tax year.

If you are paying state estimated taxes, the fourth quarter's payment is due by January 18, 2011 in most states. However, you have the option to pay it before the end of the year and move the deduction into 2010. Keep in mind that taxes are not deductible for AMT purposes.

- **Charitable Contributions** – Charitable contributions are deductible for both the regular tax and the AMT. Because they are discretionary, a taxpayer can choose when to make a payment. For example, you could prepay your 2011 tithes in 2010, thereby doubling up deductions in 2010.

Don't overlook year-end non-cash contributions of items lying around the house that are never used. As long as they are in good or better condition and are contributed to a charity before the close of the year, the contribution will count as a deduction for 2010 (provided you have proper documentation).

- **Miscellaneous Deductions** – This is a catch-all category that generally includes investment and employee business expenses. These deductions are only allowed to the extent that they exceed 2% of your AGI – but not at all for AMT purposes. Don't overlook potential losses from IRA and variable annuity accounts that have declined in value during the recession. However, utilizing these losses requires special action, so please call for details.

Because of the 2% of AGI limitation, certain otherwise-deductible expenses might be handled differently, such as working out a reimbursement plan from your employer for employee business expenses. Doing so may mean reducing your salary, but you will be converting taxable income to non-taxable reimbursement – always a desirable outcome. If your miscellaneous deductions are less than 2% of your AGI, consider paying IRA fees from the IRA account instead of making a separate payment.

If you believe you are a candidate for deduction planning, please call this office for an appointment.

## Last Chance to Qualify for the 2011 Retention Credit

The Retention Credit, available in 2011, is for retaining a previously unemployed individual hired in 2010 on payroll for a continuous 52-week period. It is a non-refundable tax credit equal to the lesser of \$1,000 or 6.2% of the employee's wages for the year.

To qualify for the retention credit, the employee must be hired before the close of 2010. An unemployed individual is one who certifies that he or she has not been employed more than 40 hours during the 60-day period immediately before his or her hire date. There is no minimum number of hours that a new employee needs to work to qualify, but the employee's pay in the second 26-week period must be at least 80% of the pay in the first 26-week period.

For additional information related to these tax benefits and how they might apply to your business, please give the office a call.



# Planning Ahead for 2011 Credit Card Income Reporting

Beginning for sales made in 2011, payment settlement entities (e.g., merchant card processing companies such as American Express, Visa, and MasterCard merchant banks) will be required to report each business's payment transactions to the IRS.

To facilitate this reporting, the IRS has developed Form 1099-K that will report a merchant's credit and debit card income for the year and will be issued to the merchant in the early part of the subsequent year, similar to the 1099s for interest, dividends, pensions, and so on. Unlike other 1099 forms, the 1099-K will actually break the income down by the month. The first 1099-Ks will be issued in early 2012.

Individuals and merchants with Internet sales (e.g., eBay and other online sales) that utilize an Internet payment system such as PayPal can expect to see those sales included in this new reporting requirement if their annual third-party transactions total more than \$20,000 and the number of transactions is over 200.

This new reporting requirement provides the IRS with a far-reaching compliance tool. It will allow the IRS to determine a business's gross income from credit/debit card sales and make it easier to segregate those payment card sales from cash sales.

The IRS will then be in a position to see if the credit card dollar figure reported on the merchant's tax return matches the bank's information return. This also allows them to see if a business's other sales from cash and check payments make sense in the context of the firm's overall business.

We can probably expect the IRS to develop statistics for various types of businesses related to the ratio of cash payments to credit payments as a means of imputing cash payments for merchants that do not report a reasonable amount of income over and above that reported by the payment processors.

## How Does This Affect You?

(1) You can expect your bank or other payment settlement services to verify your tax ID number and contact information in the next few months leading up to 2011. Be sure that the information you provide is correct and matches the information on file with the IRS.

(2) If you fail to provide the settlement entity with the information requested or the information does not match the information on file with the IRS, the settlement entity is authorized to withhold 28% of the payment as withholding. You will receive credit for the withholding when your tax return is filed, but if the withholding is in excess of what you owe, you will have to wait until your return is filed to get back the excess.

(3) Make sure your business has an appropriate accounting system in place to properly record card payments so they can be reconciled with the 1099-K.

**Payment Cards** – A payment card, as defined by the IRS regulations, includes, but is not limited to, credit cards, debit cards, and stored-value cards (e.g., gift cards or similar cards with a prepaid value). A payment card also includes the acceptance as payment of any account number or other indicia associated with a payment card. The use of a payment card to obtain a loan or cash advance does not constitute a payment card transaction. The same holds true for the withdrawal of cash from an automated teller machine – it is not considered a payment card transaction.

If you have questions related to the new reporting requirement for credit and debit card sales, how it will impact your business, or what steps should be taken to prepare for this new requirement, please give this office a call.

# New Roth Opportunities are Knocking on Your Door

2010 is the first year in which taxpayers – including married taxpayers filing separately – are able to convert funds in regular IRAs (including SEP and Simple IRAs) to Roth IRAs, regardless of income level. This can provide a significant opportunity for certain taxpayers.

**There are several advantages to a Roth IRA** – All future earnings and distributions at retirement generally will be tax-free, and Roth IRAs are not subject to the required minimum distribution rules. Because distributions from Roth IRAs are tax-free (if they are qualified distributions), they may keep a taxpayer from being taxed in a higher tax bracket than would otherwise apply if he were withdrawing taxable distributions. Roth IRAs don't enter into the calculation of tax owed on Social Security payments and have no effect on AGI-based deductions. What's more, the benefits flow through to beneficiaries of inherited Roth IRA accounts, who also can make tax-free withdrawals from such accounts (beneficiaries, however, are subject to the same annual post-death minimum distribution rules that apply to beneficiaries of regular IRAs).

**Conversion downside** – The conversions are taxable, except for previously non-deductible amounts, but they are not subject to the 10% premature distribution tax.

**Should you make an IRA-to-Roth IRA conversion?** Generally, taxpayers with the following tax profiles should consider making a conversion:

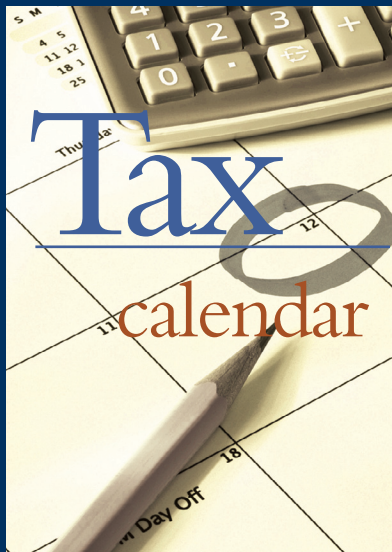
- Those who still have a number of years to go before retirement and time to recoup conversion tax dollars.
- Those in a lower-than-normal tax bracket in the year of conversion.
- Those who anticipate being taxed in a higher bracket in the future.
- Those who can pay the tax on the conversion from funds other than non-taxed retirement funds.

**Complicating factor for 2010 conversions** – A unique income inclusion rule will apply for IRA-to-Roth-IRA conversions occurring in 2010. Unless a taxpayer elects otherwise, none of the gross income from the conversion is included in income in 2010; half of the income resulting from the conversion will be includible in gross income in 2011 and the other half in 2012. This requires some careful planning since it is anticipated that taxes will rise in future years.

## Additional items to take into consideration:

- It might be appropriate for you to design your own custom conversion plan over a number of years rather than convert everything at once.
- Where does the money to pay the conversion tax come from? Generally, it must be from separate funds. If it is taken from the IRA being converted, then for individuals under age 59<sup>1/2</sup>, the funds withdrawn to pay the tax will also be subject to the 10% early distribution penalty in addition to being taxed.
- Unlike conversions, annual contributions to Roth IRAs are not allowed for certain higher-income taxpayers. However, that problem could be circumvented by contributing to a non-deductible traditional IRA and then making a conversion to a Roth IRA in a subsequent year.
- If the traditional IRA being converted consists of assets such as stocks and mutual funds that could decline in value after the conversion, it may be appropriate to apply for an automatic six-month extension to file the conversion year's return. By waiting to file until the extended due date (October 15 for most individuals), the taxpayer has an opportunity to compare the account's market value at that time to what it was when the conversion was made. If the value has dropped significantly, the taxpayer may elect to undo the conversion (called a "recharacterization"), provided certain requirements are met, and avoid paying tax on the higher value. After a specified waiting period, a reconversion can be made.

Conversions can be tricky! If you are considering a conversion, please call for an appointment so this office can help you properly analyze your conversion and contribution options.



Nov. 2010 – Apr. 2011

### November-December 2010:

It's time for 2010 year-end and 2011 tax planning. This is highly recommended if you have substantial increases in income or fewer deductions. Please call for an appointment.

### December 31, 2010:

- This is the last day to pay deductible expenses for the 2010 return. This doesn't apply to IRA, SEP or Keogh contributions, all of which can be made after December 31, 2010.
- This is the last day to set up a Keogh Retirement Account if you plan to make a 2010 contribution.

### January 18, 2011:

The fourth quarter 2010 federal individual estimated tax payment is due unless the 2010 return is filed by February 1, 2011 and the entire balance due is paid with the return. **Caution:** Some states may have different filing dates for state estimated payments. Note that the normal due date would be January 15, but because it falls on a weekend and with January 17 being a Federal holiday, the due date is January 18, 2011.

### January 31, 2011:

This is the deadline for businesses to provide 1099s and W-2s to those people they paid during 2010. If you are a business owner or rental property owner and you paid \$600 or more for the services of individuals (other than employees) during the year, you will need to provide 1099s to those workers by January 31, 2011. "Services" can mean everything from labor and professional fees to rents on property. In addition, in order to avoid a penalty, copies of 1099s need to be sent to the IRS by February 28, 2011. This firm can prepare these documents for you.

### February 28, 2011:

This is the deadline for filing (sending) 1099s and W-2s to the government.

### April 18, 2011:

- This is the deadline for individuals to file a 2010 federal income tax return or request an extension of time to file.
- The first installment of the 2011 federal individual estimated tax payment is due. **Caution:** Some states may have different filing dates for state estimated payments.
- The first installment of the 2011 defined benefit pension plan contributions is due.

The purpose of this newsletter is to provide current information on tax, financial and business developments. It suggests general tax planning ideas that may only be appropriate when claiming tax benefits in a manner consistent with the statutes and Congressional purpose. The information and opinions are generalizations and may not apply to all taxpayers and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. Therefore, it is important that you seek appropriate advice before implementing any of the ideas suggested.



Since You  
Asked...



**You Asked:** My wife and I are getting a divorce. As part of the property settlement, she will keep the home. What are the possible tax consequences that may arise?

**Answer:** When property is divided up in a divorce, there are no immediate tax consequences. Therefore, the transfer of your interest in the home to your spouse will not result in a taxable gain or loss to either you or your spouse. However, let's say that she assumes the home at the community basis. Generally, community basis is what was jointly paid for the home plus the cost of improvements that were made. Thus, she would be responsible for reporting any gain in excess of the community basis when, and if, she sells the home. If she qualifies, she can exclude the first \$250,000 of gain; any part of the gain in excess of the exclusion will be taxable to her. As part of your divorce tax strategy, and assuming you qualify for the home gain exclusion, you might want to consider selling the home jointly. This will convert the asset to cash, which can then be divided up as part of the settlement. By doing so, you will have a combined \$500,000 home gain exclusion and will only be taxed on the amount, if any, in excess of this larger exclusion amount.