

TAX & BUSINESS STRATEGIES



SPRING 2010 INSIDE:

- ▶ Tax Calendar
- ▶ Time is Running Out for the Homebuyer Tax Credit
- ▶ Say Goodbye to Business Tax Breaks that Expired in 2009
- ▶ 2010 Sees Increase in Domestic Production Deduction
- ▶ Tax Credit for Home-Energy Improvements is Almost Out the Door!
- ▶ Foreign Accounts Targeted: Comply with Reporting Requirement or Face Stiff Penalties
- ▶ Since You Asked...

Time is Running Out for the Homebuyer Tax Credit

If you (or your spouse) are at least 18 years of age and plan on taking advantage of the liberalized homebuyer tax credit, time is running out. Unless extended by Congress, this refundable tax credit will no longer be available for homes purchased after April 30, 2010 or after June 30, 2010 when a binding contract to purchase was entered into prior to May 1.

The homebuyer credit is 10% of the purchase price but not exceeding \$8,000 for first-time homebuyers and \$6,500 for long-time residents. This refundable credit is yours to keep, even if you are subject to the alternative minimum tax, as long as the home continues to be used as your principal residence for 36 months after purchase.

A qualifying home can include a conventional single-family structure, house trailer, mobile home, houseboat, cooperative apartment, condominium, duplex, or row house as long as it can qualify as the buyer's principal residence but not exceed \$800,000 in cost.

You also have the option to claim the credit on your 2009 tax return, thus putting the money into your hands more quickly. When making the decision to claim the credit in 2009 or 2010, the homebuyer will need to consider in which year the credit will provide the most benefit. This is because the credit phases out for higher-income taxpayers based upon the taxpayer's AGI. So, if you qualify for the credit and your income is in the credit phase-out range, you probably will want to claim the credit in the year with the lower income. The credit is ratably phased-out for individual taxpayers between \$125,000 to \$145,000 (\$225,000 and \$245,000 for married taxpayers filing jointly).

A taxpayer is considered a first-time homebuyer if he or she had no present ownership interest in a principal residence in the U.S. during the 3-year period before the purchase of the home to which the credit applies. A long-time resident is any individual who has owned the same principal residence for any 5 consecutive years during the 8-year period ending on the date of purchase of a subsequent principal residence. Caution: If either spouse fails the first-time homebuyer or long-time resident definition, neither gets the credit (even if filing separately).

To prevent fraudulent claims of this credit, the IRS is requiring additional documentation to be attached to the return, including a copy of the final settlement statement (generally Form HUD-1) from the purchase or the certificate of occupancy for a newly-built home. In addition, long-time residents must attach documentation (such as mortgage interest statements, property tax records, or homeowner's insurance records) for the 5-out-of-8-years consecutive period being used to claim the credit.

In addition to the credit, the tax law also allows first-time homebuyers to make a penalty-free withdrawal of up to \$10,000 from their IRAs for the purchase of a home. Married individuals each can withdraw up to \$10,000 from separate IRA accounts for this purpose. Although the withdrawal is penalty-free, it is still taxable, so you should consider carefully the tax ramifications and the impact on your future retirement before invading your IRA accounts.

It would probably be appropriate to consult with this office in advance of a home purchase if you or family members are contemplating utilizing the new credit or withdrawing from an IRA.

Dear Client:

The new year brings about many changes, so this newsletter edition gives you a brief overview to help you prepare for the tax season. To discuss the full benefits of these changes, please give this office a call.

One important tax benefit to take note of is the home energy improvement credit. Unless Congress decides to extend it, 2010 may be your last opportunity to take advantage of the tax credit for residential energy improvements. If you think you may qualify for this credit, please make an appointment with this office so we can discuss your situation.

Another tax credit to watch out for is the homebuyer tax credit. Unless extended by Congress, this refundable tax credit will no longer be available for homes purchased after April 30, 2010 or after June 30, 2010 when a binding contract to purchase was entered into prior to May 1.

Many business tax breaks also expired at the end of 2009, such as the five-year depreciation for farming business machinery and equipment and the enhanced charitable deduction for contributions of book inventories to public schools. A complete list has been compiled for your review. Again, unless Congress acts to retroactively restore them, these tax breaks will not be available in 2010.

Keep in mind that there are many other areas that could help minimize your tax liability, so please call our office for an appointment to discuss your specific needs.



Say Goodbye to Business Tax Breaks that Expired in 2009

Although there is some talk of extension, unless Congress acts to retroactively restore them, the following business tax breaks that expired on December 31, 2009 will not be available in 2010:

- The additional first-year 50% bonus depreciation for qualified property, generally equipment, machinery, electronics, etc.;
- The \$8,000 increase in the first-year depreciation limit for passenger automobiles used in business;
- The Sec. 179 expense deduction for 2010 is substantially reduced. The maximum amount that may be expensed is \$134,000 (down from \$250,000 for 2009). The maximum annual expensing amount generally is reduced dollar-for-dollar by the amount of property placed in service during the tax year in excess of \$530,000 (down from \$800,000 in 2009).
- The five-year depreciation for farming business machinery and equipment;
- The fifteen-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements;
- The credit for construction of new energy-efficient homes (this provided a credit of up to \$2,000 for site-built homes and \$1,000 to \$2,000 for manufactured homes);
- The enhanced (greater than cost) charitable deduction for contributions of food inventory by a non-corporate taxpayer from its trade or business of apparently wholesome food inventory for the care of the ill, needy, or infants;
- The enhanced charitable deduction for contributions of book inventories to public schools;
- The enhanced deduction for corporate contributions of computer equipment for educational purposes;
- The seven-year straight-line cost recovery period for property used for land improvement and support facilities at motorsports entertainment complexes;
- The film and television producers' election to expense the first \$15 million of production costs incurred in the U.S. (\$20 million if the costs are incurred in economically depressed areas in the U.S.); and
- The credit for eligible small business employers equal to 20% of the sum of differential wage payments to activated military reservists.

If you have questions relating to any of the above, please give this office a call.

Foreign Accounts Targeted: Comply with Reporting Requirement or Face Stiff Penalties

Each U.S. person who has a financial interest in or signature or other authority over any foreign financial accounts (including bank, securities, or other types of financial accounts in a foreign country), if the aggregate value of these financial accounts exceeds \$10,000 at any time during the calendar year, must report that relationship to the U.S. government each calendar year.

The government uses this reporting mechanism as a means to uncover hidden foreign accounts and ensure that investment income earned in foreign countries by U.S. taxpayers is included on their U.S. tax returns. The Treasury Department has placed a new emphasis on foreign accounts, and taxpayers with a financial connection to a foreign country should determine whether they have a reporting requirement.

Reporting is accomplished by filing a "Report of Foreign Bank and Financial Accounts" – more commonly referred to as the "FBAR" – which is due on or before June 30 of the succeeding year. No extensions of time are available for filing this form. In addition, taxpayers generally are required to answer "yes" or "no" to questions related to foreign bank and financial accounts on their tax returns.

Penalties for failing to comply can be draconian. For non-willful violations, civil penalties up to \$10,000 may be imposed; the penalty for willful violations is the greater of \$100,000 or 50% of the account's balance at the time of the violation. A reasonable cause exception to the penalty is available for non-willful violations but not for willful violations.

Overlooked Accounts – Many taxpayers overlook the fact that they have a reporting requirement in situations such as the following:

- **Family Accounts** – Recent immigrants to the U.S. may still have parents or other family members residing in the "old" country, and those relatives may have included them on an account in the foreign country. This is common practice for some ethnic groups. The taxpayer does not really consider the account his or hers, but it falls under the reporting requirement if he or she has signature or other authority over the account and the value exceeds \$10,000.
- **Inherited Accounts** – Accounts in a foreign country and inherited fall under the FBAR reporting requirement even if the funds are subsequently transferred to the U.S. The FBAR rules state that reporting is required if at any time during the year the foreign account exceeds \$10,000.
- **Business Accounts** – An officer or board member may have signature authority over a business account held in a foreign country and overlook the need to meet the FBAR reporting requirements.

In addition to including any reportable foreign income on one's tax return, a taxpayer must ensure that the foreign account questions are completed correctly on the tax return and that the FBAR is filed when required. If you have questions regarding this reporting requirement, please contact this office.

Tax Credit for Home-Energy Improvements is Almost Out the Door!

Unless Congress decides to extend this tax benefit, 2010 may be your last opportunity to take advantage of the tax credit for residential energy improvements. A residential energy improvement that qualifies for the credit generally is one that makes more efficient use of energy and should not be confused with the larger credits available for generating power through the use of solar, wind, and geothermal systems, which continue through 2016.

The credit is 30% of the home energy improvement costs, with a combined maximum credit of \$1,500 for 2009 and 2010. So, if you qualified for this credit in 2009, the maximum credit available for 2010 must be reduced by the amount of credit taken in 2009. The credit is available only for improvements to a taxpayer's primary residence.

Improvements must have a reasonably expected useful life of at least 5 years, and generally, the following energy-efficient items qualify:

- exterior windows and skylights,
- exterior doors,
- metal roofs with appropriate pigmented coatings,
- asphalt roofing with appropriate cooling granules,
- heating systems,
- air conditioning systems, and
- insulation materials or systems designed to reduce heat loss or gain.

Caution! Not all improvements qualify for the credit. To qualify, the improvements must be certified by the manufacturer to meet certain standards for this credit. The certification must be in the form of a written statement, such as with the packaging of the product, or in a printable format on the manufacturer's website. So, do your homework before proceeding.

Installation costs cannot be counted for the credit; only the actual cost of the component qualifies. However, with today's economy being what it is, you probably can negotiate a very favorable installation cost.

If you have questions about how this credit applies to your specific tax circumstances, please give this office a call.

2010 Sees Increase in Domestic Production Deduction

The domestic production deduction was created to encourage manufacturing and production within the U.S., and it provides a substantial business deduction equal to 9% (up from 6% in 2009) of the lesser of:

- (1) the taxpayer's net income from qualified production activities or
- (2) the taxable income (modified adjusted gross income for individual taxpayers) without regard to this deduction for the tax year.

The deduction is further limited to 50% of the W-2 wages of the employer for the tax year allocable to the activities eligible for the deduction.

Domestic Production Activities – Although the definition of "domestic production activity" is a little elusive, it generally does not include retail sales or purely service activities. Among the more common eligible activities are:

- manufacturing and production activities in whole or in significant part within the U.S.,
- construction of real property in the U.S., and
- performance of engineering or architectural services in the U.S. in connection with real property construction projects in the U.S.

The following example, one that was used in a Congressional hearing, does a good job of defining what is and is not a qualified domestic production activity: Suppose you are a baker and in the business of producing donuts. You sell some of the donuts at retail, and some you sell in bulk to hotels and restaurants. The production costs of the donuts sold at retail do not qualify for the deduction, while the costs associated with the wholesale sales to the hotels and restaurants do.

Computing the Deduction – The following is an example of how this deduction works: Suppose your business manufactures a product that you wholesale to retailers. Your net income from sales of that product for the year is \$800,000, and the wages you paid to your employees to manufacture that product totaled \$200,000. Your deduction for 2010 would be the lesser of 9% of the \$800,000 in revenue or 50% of the \$200,000 wages. Thus, the domestic production activities deduction for your business would be \$72,000 (.09 x \$800,000). The deduction is allowed for both regular and alternative minimum tax purposes.

Who Receives the Deduction – This deduction is allowed to all taxpayers, including individuals, C corporations, farming cooperatives, estates, trusts, and their beneficiaries. The deduction is allowed to partners and owners of S corporations (not to partnerships or the S corporations themselves) and may be passed by farming cooperatives to their patrons. And, despite the deduction's history, it is fully available to taxpayers who do not export.

The foregoing is only an overview of this deduction. If you have questions related to how the domestic production deduction might apply to your specific circumstances, please give this office a call.



March 1, 2010:

– This is the deadline for filing (sending) 2009 1099s and W-2s to the government unless you file electronically.

March 15, 2010:

– The 2009 calendar year Corporation and S Corporation returns are due, including any taxes owed. This is also the due date for providing Schedule K-1 to the S Corporation shareholders. If you cannot file the Corporation return by the March due date, file for the automatic six-month extension.

March 31, 2010:

– This is the due date for electronically filing 1099 forms, W-2 forms, W-2G forms and tip reporting. File these forms electronically if you did not previously file paper versions of the forms on March 1.

April 15, 2010:

– The first quarter estimated tax installment payment for the 2010 tax year is due.

- This is the filing due date for your 2009 income tax return and to pay any tax due.
- If you cannot file by the April 15 due date and you expect to owe, estimate how much and include your payment with an extension. If you owe taxes when ultimately filing your extended tax return, you will be liable for both the late payment penalty and interest from the due date.
- This is the filing due date for the 2009 calendar-year Partnership return(s) and to provide Partnership Distribution forms (Form K-1) to the partners. If you cannot file a Partnership return by the April due date, file for the automatic five-month extension.
- This is the last day to make an IRA contribution for tax year 2009.
- This is the last day to make SEP or Keogh contributions unless an extension is filed.

April 30, 2010:

– This is the last day to qualify for the homebuyer credit by purchasing a qualified home or entering into a binding contract to purchase a qualified home by June 30, 2010.

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.

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SINCE YOU ASKED...

YOU ASKED: I have heard that there is a substantial penalty for filing a partnership return late. Can you explain?

ANSWER: Income from both partnership and S corporation returns passes through to the partners or stockholders. Therefore, filing these returns late creates hardships for the partners or stockholders to timely meet their own filing obligations. As a result, the government has imposed some substantial penalties for failure to timely file partnership and S corporation returns.

The penalty is a statutory dollar amount times the number of partners or shareholders for each month (or fraction of a month) that the failure continues, up to a maximum of 12 months. The base amount on which a penalty is computed is \$195 per partner or shareholder for returns due for tax years starting in 2010. This is a substantial increase from the previous amount of \$89 per partner or shareholder that applies if the entity's tax year began in 2009. As an example, if your partnership files its 2010 return late and has four partners, the penalty will be \$780 (\$195 x 4) per month. The IRS may waive the penalty if there is reasonable cause for the late filing.

YOU ASKED: My wife and I are divorced, and she claims our 10-year-old daughter as a dependent. Our daughter needs braces, and we want to get the best tax benefit from the dental expense. Any suggestions on how to proceed?

ANSWER: Since she is a dependent of your ex-spouse, your daughter is what is referred to as a "medical dependent" to you, and your daughter's medical expenses (including dental work) can be deducted by the parent who actually pays them. Thus, if you pay the dental or other medical expenses, you can deduct them even though you don't claim your daughter's exemption on your tax return. Another issue is that deductible medical expenses are reduced by 7.5% of the taxpayer's AGI. So, it may be a tax benefit to pay the dentist up-front for the entire cost if doing so results in more total medical expenses being deductible than would be the case if the dental payments were spread over multiple years. You also might consider one or the other of you paying all of your daughter's medical expenses for the year to maximize the amount that exceeds 7.5% of AGI. Lastly, the AGI reduction goes from 7.5% to 10% if you are taxed by the alternative minimum tax. You will need to run some scenarios to determine the best course of action.