

# CLEMENT & ASSOCIATES

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## 2011 TAX LAW CHANGES & UPDATES

### Quiet Year, but Expect Changes in 2013

I will probably use this word multiple times, but Congress has been dysfunctional during the last few years—so much so that we no longer have a long-term tax policy.

It seems inevitable that with the budget deficits, tax rates have a greater chance of increasing than decreasing in 2013. This is especially true when you consider our current tax rates are some of the lowest we have ever seen. Most of us never experienced the high tax rates following World War II when the lowest rate started at 20% (it now starts at 10%) and topped out at 94%. Nor do we remember that the top rate was 70% through the 1970's.

Now is the time to begin planning for withdrawals from retirement accounts if you are age 59 and older or increasing retirement contributions if you are under age 59. Look at possibly taking capital gains during 2012 if the market gives you that opportunity. Plan for tax laws to change and to possibly lose deductions which many of us consider our right to deduct. Current talk includes limiting the mortgage interest deduction on second homes and even lowering the \$1.1 million threshold, limiting deductions of state income taxes and possibly even property taxes, and even limiting charitable deductions beyond the current 50% limit.

### New 1099 Reporting Requirements

The IRS had two new reporting requirements this year. The first impacts businesses as credit card companies such as Visa, MasterCard and American Express will be reporting income processed through them. It is possible to have income reported twice if the party paying you issues a 1099 under the rules that require 1099's to be issued for services rendered to an independent contractor. You could have a 1099 from the payer and that same income included on the 1099 issued by the Credit Card Company if a credit card was used to pay you. We can work with this, but you need to be aware of the issue.

In 2012, brokerage firms are required to begin reporting the cost basis of the stock or mutual funds you sell. You need to review your brokerage statements to be certain that the cost they show is accurate.

Your broker should give you the option to make a selection as to which cost method you want to use. Most brokers will use the average cost method, especially for Mutual Funds, unless you designate another method. The average cost method takes all purchases of a specific stock and divides the combined purchase prices by the number of shares you own.

You have two other methods. One is to elect to sell on a First in, First Out basis. The earliest purchase will be reported as the cost for stocks sold when you purchase a stock multiple times. The second method allows you to designate specific lots when stocks are sold. When you purchase shares of a stock multiple times, you designate the specific stocks to be sold by lot or purchase date.

### Estate & Gift Tax Returns—Important to File!

Congress increased the maximum exclusion for gift and estate taxes to \$5 million through 2012, and also created a new benefit allowing unused exemptions to carry over to the surviving spouse. The IRS has just announced that in order to take advantage of that carryover benefit, an estate tax return must be filed to establish the estate value and record the carryover.

Congress never intended to allow the estate and gift tax to drop to -0- in 2010, but with their being as dysfunctional as they have been, it happened. When they did re-establish the estate tax at \$5 million, it was only through 2012. The expectation is that the exemption will not remain at \$5 million. There is a strong likelihood it will be reduced.

If you are married and your joint estate will exceed \$2 million, we are recommending that you consider filing an estate tax return to preserve unused credits. You will want to weigh the cost of filing the return with the prospect of your estate increasing in value. Give us a call to talk about whether filing a return is worth doing if the situation arises.

### Did a Foreclosure or Debt Reduction Occur?

The IRS normally requires you to pay tax on any debts that are forgiven. This includes credit card debt written off as well as the unpaid portion of a home loan when there is a short sale or the home is sold in foreclosure.

There is an exception to this requirement to pay tax on forgiven debts. The exception is when your debts exceed your assets (insolvency), or you file bankruptcy.

Congress extended the exception to this rule for debt forgiveness when it is your primary residence and is acquisition indebtedness. If you have refinanced your home and used all additional proceeds to improve the home, your debt forgiveness will not be taxed when under \$2 million. If part of the loan is not considered acquisition debt, you will pay tax on that portion of the forgiven loan unless you meet the exceptions mentioned in the previous paragraph. If you have debt forgiveness on your home, call us to review the details with you as this is complicated. We will need copies of the most current loan statement(s) and escrow closing statements for the initial purchase and loan refinances.

### IRS Audit Issues

We are seeing more audits by the IRS this year with a focus on Schedule C's, Home Mortgage Interest and Rental Properties. If you receive any notices, please fax or scan both sides of the notice ASAP and then call us. We can usually tell very quickly what the issue is if we have the notice in front of us and it saves all of us time.

**Schedule C** -The IRS had made a major focus on auditing Schedule C's this year. Specifically, they are examining travel, business meals, and employees vs. contractors.

When the IRS looks at the Employee vs. Subcontractor issue, (W-2's vs. 1099's), they are searching for independent contractors who should be treated as employees. If you are paying individuals who are not licensed or who work primarily for you, you are responsible to pay them as an employee, not as an independent contractor.

**Home Mortgage Interest** is another focus of the IRS. They are looking to see if you have refinanced your mortgage or taken out a Home Equity Line of Credit that is more than \$100,000 greater than what your initial mortgage was at the time of refinance. For those refinancing, never throw out your escrow closing statements as we will need to go back to those statements. We will be asking more questions this year and may need to request ending loan balances.

**Rental Properties** are becoming a focus of the IRS. The Government Accountability Office stated recently that at least 53% of individual taxpayers with rental real estate misreport their income. They are focusing on rental property with minimal income and large expenses.

### **1099 Requirement Changed (Oops Maybe Not!)**

Many of you own a business and hire subcontractors or pay commissions or rents during the year. If you pay \$600 or more for services to an individual, attorney, or unincorporated business, you must prepare and file a 1099-MISC. The 1099 must be given to the person or company by January 31 and filed with the IRS by the end of February.

Congress passed a law expanding this requirement to include payments to anyone paid from a business for any reason—goods as well as services. They added landlords to the definition of a business. Congress just reversed this requirement, landlords included, and we are back to the requirement in the above paragraph.

The IRS is, however, focusing on enforcing the filing requirements and increased the penalty for non-filing to as much as \$250 per missing form if the IRS audits you and discovers you did not file 1099's. You have until February 29 to mail the return or until March if you electronically file the forms through the web. The IRS holds us, as tax preparers, responsible if we claim deductions when 1099's should have been filed. Because of this, we will not be able to take a deduction for independent contractors until 1099s have been filed. Give us a call for help with filing those forms or search online for 1099 filing services.

### **Identity Theft**

Identity theft is now the number one crime in the world. If you have had your identity stolen, the IRS requires that you file a report with your local police dept. The IRS never sends unsolicited emails. Never respond to an email that appears to be coming from the IRS—it is fraudulent!

Identity theft is one of the reasons we have begun using our secure portal to send all documents to you. It is available year round and we encourage you to use this portal to send us any and all documents. We will be adding an identity theft reporting kit on our website in early 2012.

### **Roth Conversion & IRA/Retirement Plans**

Anyone can roll their traditional IRA into a Roth IRA as there are no income limitations. If tax rates go up in future years, a rollover in 2011 or 2012 will be a wise decision as all earnings are nontaxable so long as you are over 59 ½ and have had the Roth IRA for at least 5 years.

If you have funds in a Profit Sharing Plan, SIMPLE IRA or any other type of retirement plan, you will not be allowed to make a direct rollover to a Roth IRA. However, if you can withdraw those funds and roll them into a traditional IRA, you might be allowed to then roll the funds to a Roth IRA. Give us a call as there are limits as to how many rollovers can be done each year.

The maximum contribution to a Roth or Traditional IRA is \$5,000 for 2011 and 2012. If you are over 50, you can increase the maximum contribution to your IRA by an additional \$1,000.

If you are in a Traditional or Roth 401(k) plan, a 457 plan, or a 403(b) plan, your maximum contribution is \$16,500 for 2011 and increases to \$17,000 for 2012. If over 50, add \$5,500 to the maximum contribution.

Contributions to a profit sharing plan for small businesses are now 25% of compensation or 100% of an employee's earnings, up to a maximum of \$50,000 if a "Defined Contribution Plan" is established.

Employees participating in a SIMPLE IRA can contribute up to \$11,500 from their paychecks for 2011 and 2012. If 50 and older, increase this amount by \$2,500.

If you turned 70 ½ during 2011 or prior, you have a required minimum distribution (RMD) that must be paid to you before December 31.

### **Do You Buy Through Amazon or Online?**

States are becoming aggressive in collecting sales tax (also known as use tax) when purchases are made out of state. California, New York and Illinois are among the most aggressive states as their budget shortfalls are some of the greatest.

Many states have added a line to the tax return to report uncollected sales tax. Their focus is on purchases online or out of state where sales tax was not collected. Be aware that we will be asking this year if you purchased anything online and if so, we need to report that to the state.

### **Foreign Bank Account Reporting—New Forms**

The IRS is now assessing significant penalties when foreign bank and investment accounts are not reported. There is a disclosure requirement if you have any foreign bank or investment accounts and detail reporting if you have \$10,000 or more in a foreign account at any time during the year.

We will be asking if you have any foreign bank or investment accounts. The IRS has added a new form this year which must be filed with your tax return. This is in addition to Form 90-22.1 which must be filed with the Treasury Department.

### **Depreciation & Section 179 Deduction**

Congress increased the amount of equipment and furnishings that businesses can write off in the year of purchase. They are trying to stimulate growth to encourage more hiring and increased the amount of the write-off to \$500,000, so long as total equipment purchases do not exceed \$2 million. In 2013 the maximum write-off drops to \$25,000, and phases out when purchases exceed \$200,000. Few of us will exceed this amount for 2011, so effectively all equipment and furnishings can be written off in the year purchased.

Bonus depreciation for 2011 can be 100% of the purchase price of new equipment and furnishing. It drops back to 50% in 2012.

### **IRS Mileage Rate For 2011 & 2012**

The IRS mileage rate started at 51 cents in 2011, and in July increased to 55.5 cents per mile. Medical and moving mileage was adjusted to 19.5 cents in January and was increased to 23.5 cents per mile in July. Charitable mileage remains at 14 cents per mile for 2011. These rates hold through 2012, except for medical and moving which drops to 23 cents per mile.

### **Claiming a Dependent When a Divorce Occurs**

Effective for divorces finalized in 2009 and later, the IRS is now requiring that the noncustodial parent who claims an exemption for a child must have Form 8332 completed and signed by the custodial parent. There are no exceptions to this rule, so if you go through a divorce and are not identified as a custodial parent, you must receive Form 8332 giving you the right to claim your child as a dependent.

## **TAX PLANNING STRATEGIES**

Tax planning should be done throughout the year, not solely at year end. Unless you will be impacted by the AMT (in which case the recommendations are usually reversed), it is often beneficial to accelerate all possible deductions into the current year.

**Contribute the maximum possible** to a 401(k) plan, Tax Sheltered Annuity, Deferred Compensation Plan, SEP, and/or IRA (preferably a Roth IRA). Those who acquaint themselves with our philosophy of financial planning understand the long-term value of investing the maximum possible in such a plan. An added plus is that your employer will often match your contributions. This can double your contribution and maximize your future earnings.

In fact, you should contribute to a Roth IRA even if you have a 401(k), SEP, IRA, or 403(b) plan at work. Unless your income exceeds \$107,000 for a single individual (\$169,000 for a married couple) or you file as married filing separate, take advantage of the Roth IRA.

**Shift income to children** when taxable income exceeds \$69,000 for a married couple in 2011 (\$34,500 for singles).

Children under 18 can make \$1,900 of unearned income (i.e. interest, dividends, and capital gains) before having to pay tax at their parent's rate. Children under 18 can also be paid a wage from their parents business (proprietorship or partnership only) and earn up to \$5,700 without paying taxes as long as they have no unearned income. In addition, their parents need not pay social security or unemployment taxes on those earnings.

Don't forget about the ability to make gifts, now at \$13,000 (\$26,000 for couples) per year for 2011 to as many individuals as you desire. This provides a way to transfer assets to your children. You also have a gift tax exemption up to \$5,000,000 in 2011, in addition to the annual gift.

Be aware, there is a potential conflict with shifting income to children. If you are trying to qualify for college scholarships or loans, 35% of a student's assets must be considered available to pay tuition and reduces the ability to qualify for grants and low interest loans. Less than 6% of parents' assets are considered.

**Alternate capital gains and capital losses.** Sell stocks with gains one year and those with losses in a different year, so long as the losses are no more than \$3,000 and you are in the 25-35% brackets. Capital losses up to \$3,000 can be written off against ordinary income taxed at maximum rates. Capital gains on the other hand are taxed at a maximum rate of 15%.

If you have significant capital losses, then take those losses in a year with significant capital gains so that you can realize the benefit of the losses. This way you will be allowed to deduct losses equal to the amount of capital gains in that year, plus \$3,000. If the stock is worthless, sell it to an unrelated party for \$1 and document the sale. Do not repurchase the same stock within 30 days as the loss will be disallowed.

**Selling real estate? Do a tax-deferred exchange.** A 1031 exchange can postpone tax on the sale of real estate until you sell the property received in the exchange. There are strict time requirements and limits on how you must handle debt and the proceeds from the sale. In addition it will cost \$1,000-3,000 in accommodator and professional fees to handle the exchange.

### **Accelerating Deductions**

**Pay your January 1 mortgage payments** for your home and rental properties by Christmas to enable the lender to receive and record the payment by December 31. Unless the lender receives and records the payment by December 31, they will report the payment of interest in the following year.

**Accelerating contributions** from next year into this year can be a very profitable move. This is one area Congress has never really touched, other than requiring receipts from the charity. Take full advantage of donating to your favorite charity. This includes clothing and other goods that should be donated by December 31. Do remember to obtain a receipt for any food or clothing donated.

**Consider the following unless you will be affected by the Alternative Minimum Tax.**

**Bunch your medical expenses** every other year unless they exceed 7.5% of your AGI by a significant amount each year. For example, if you are making payments for orthodontia work, prepay as much as possible in the current year.

**Prepay next year's property taxes** by December 31 if they are due within the first four months of the year.

**Pay 4th quarter state income tax estimates** by December 31. This estimate is due on January 15. By paying 15 days

early, you receive the deduction a year earlier. This does not apply to the Federal estimate.

**If miscellaneous deductions exceed 2% of your AGI**, (i.e. \$1,000 for an AGI of \$50,000) accelerate all possible expenses into the current year. Most of our clients have sufficient job related expenses, investment deductions, and other deductions (including job-search expenses, continuing education, and tax preparation fees) to make it well worth your while to accelerate those expenses into this year.

### THIRD-PARTY SERVICE PROVIDERS

Clement & Associates uses third-party service providers to provide professional services for our clients. If you should have any questions concerning this disclosure, please feel free to contact Steve and he will be happy to answer any questions you may have. This notice is in compliance with professional standards established by the American Institute of Certified Public Accountants (AICPA Professional Standards ET Sections 191.224-225 & 291.023-024).

### LENDER REQUESTS FOR TAX RETURNS

We now keep a copy of your tax return on our portal for you to download and forward to a lender. We no longer will send returns directly to the lender because of strict IRS regulations.

### IS YOUR EMAIL ADDRESS CORRECT?

During tax season, Steve will usually return emails when he cannot return phone calls due to the time constraints of his appointment schedule. Please make sure we have your current email address when you return your appointment card or the next time you call us. You can reach us at the following addresses:

Eadrina Stubblefield	(Appointments, status of returns)	<a href="mailto:Receptionist@clementcpa.com">Receptionist@clementcpa.com</a>
Edyth Chung	(Status of returns, missing information)	<a href="mailto:Edyth@clementcpa.com">Edyth@clementcpa.com</a>
Pattie Hagen	(Accounting/tax questions, missing info)	<a href="mailto:Pattie@clementcpa.com">Pattie@clementcpa.com</a>
Jeremy Craig	(QuickBooks® accounting & business tax returns)	<a href="mailto:Jeremy@clementcpa.com">Jeremy@clementcpa.com</a>
Steven Clement	(Tax/QuickBooks®/financial planning questions)	<a href="mailto:Steve@clementcpa.com">Steve@clementcpa.com</a>

### WEB PAGE, NEWSLETTER, AND CHECKLISTS

Have you checked out Tax Tools on our web page at [www.clementcpa.com](http://www.clementcpa.com) lately? We have interactive worksheets for Non-Cash Contributions, Sch. C, Rentals, Auto Expenses, Employee Business Expenses, and other helpful checklists under Tax Tools. We are also sending out a monthly newsletter via email. If you have not begun receiving this newsletter by the time we meet for your tax appointment, please let us know.