

# CLEMENT & ASSOCIATES

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### 2009 TAX LAW CHANGES & UPDATES

#### Roth Conversion & IRA/Retirement Plans

Roth IRAs are looking very attractive and beginning January 1, 2010, anyone can roll their traditional IRA into a Roth as there will be no income limitations. If tax rates go up, a rollover in 2010 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 an 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 me 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 2009 and 2010. 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 2009. 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 \$49,000 if a "Defined Contribution Plan" is established.

Employees participating in a SIMPLE IRA can contribute up to \$11,500 from their paychecks for 2009. If 50 and older, increase this amount by \$2,500.

#### Credit for Home Buyers Extended/Expanded

Congress extended the incentive for first time home buyers **and also made it possible for current owners to qualify for a lesser incentive** through April 30, 2009. You can claim a refundable tax credit equal to 10% of the purchase price of a new home up to \$8,000 for a first time home buyer and \$6,500 (\$3,250 for singles) for someone who is currently a homeowner and has lived in their home for at least 5 years. Of course, there is a phase-out if your income exceeds \$225,000 for married couples and \$125,000 for single individuals.

#### 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. This is very complex and if you are in this situation, please call us so that we can review the details with you. We will need copies of the most current credit card and loan statement(s) and escrow closing statements for the initial purchase as well as the loan refinancing.

#### Yes, Santa Clause exists! (Capital Gains)

...that is if you can keep your taxable income fairly low and really do have some long-term capital gains. Long-term capital gains (some items excluded) will not be taxed by the IRS in 2009 & 2010 if your taxable income is below the top end of the 15% tax bracket, which for 2009 is \$67,900 (\$33,950 for single individuals). Most states, however, will still tax capital gains!

Long-term capital gains, for those who are in the 25% and higher bracket, are taxed at a maximum rate of 15%. The rates will go up if Congress takes no action before 2011.

I cannot emphasize enough that these are the lowest rates we have ever seen for capital gains and who knows what will happen for 2011. Take advantage of these low rates to sell assets which have gains and which you are ready to sell. Don't hold back on selling just because you will be taxed. Many of you have significant losses which can be used to lower your total tax. However, if your losses are small, try the strategy discussed later in the tax planning section.

Art, antiques, gems, stamps, coins, & other collectibles are excluded and are taxed at a 28% rate. Depreciation recapture on real estate is taxed at up to 25%.

#### Maybe Not! (AMT)

While Congress reduced the tax on long-term capital gains, they still left intact the law relating to the Alternative Minimum Tax (AMT).

If your income exceeds \$70,950 (\$46,700 for singles) and includes a significant amount of capital gains and dividend income taxed at the 15% rate, you may be subject to the AMT.

**When income exceeds \$150,000 (\$112,500 for singles) certain exemptions begin to phase out and you will more than likely pay the AMT.**

The AMT allows you deductions for “qualified” home mortgage interest, charitable contributions, and almost nothing else. Deductions for state income taxes, property taxes, business expenses, personal exemptions, as well as credits for children, childcare, or other credits are ignored. Then the tax is calculated at a flat rate of 26-28% on all income in excess of \$70,950. If this exceeds your regular tax, you pay the higher amount.

If you have significant capital gains this year, want to prepay your property taxes, or plan to claim a significant amount of investment or business expenses on Schedule A, please call us before making last minute deductions as part of your year-end tax strategy.

### **Capital Gain Exclusion on Sale of Residence**

Congress decided to change the rules for those converting a rental to their primary residence. If you acquired a rental property using a 1031 (tax-free) exchange and convert it to a primary residence, you must hold the home for more than 5 years to take advantage of the \$250,000 per person exclusion.

Effective in 2009, if you convert a rental property into your primary residence, the gain occurring while the property was a rental will be taxed and only the gain occurring while the property is your primary residence can qualify for the \$250,000 per person exclusion.

### **Convert Home to Rental to Take a Loss? - No!**

Thinking about converting your home to a rental property because you now have a loss on it or cannot sell it and need to move? The IRS only allows you to claim a loss on the sale of a rental or investment property based on the value of the property at the time it was converted to a rental. If you paid more for the home than it is now worth, the IRS requires you to determine its value at the time you converted it to a rental. This is the value used to calculate depreciation and a loss when it is sold. Your best plan of action is to get an appraisal at the time the property is converted.

### **Electric Vehicle & Energy Tax Credits**

Congress is encouraging us to purchase plug-in electric vehicles. Beginning with 2009, you can receive a credit of up to \$7,500 for purchasing a vehicle up to 10,000 pounds. The minimum credit in 2009 is \$2,500 for vehicles powered by a 4-kilowatt hour battery and a \$417 credit is added for every additional kilowatt hour of battery power up to the maximum. In 2010 the vehicle must be powered by at least a 5-kilowatt hour battery. This credit can go as high as \$15,000 for purchasing a vehicle over 10,000 lbs gross vehicle weight. This credit phases out after a total of 200,000 cars are sold in 2010.

Have you been considering installing a solar energy, wind or geothermal system in your home? There is currently a credit equal to 30% of the purchase price,

with no cap. The 30% credit for other energy savings devices such as insulation, windows, water heaters, heat pumps, air conditioning, etc. continue through 2010 with a cap of \$1,500 combined for both years.

### **Not Itemizing? Claim a Tax Deduction**

If you claim the standard deduction and pay **property taxes**, you can claim up to \$1,000 (\$500 for singles) in addition to the standard deduction. For 2009 only a deduction for **sales tax** paid on a new auto based on a purchase price up to \$49,500 is allowed if your AGI is under \$250,000 (\$125,000 for a single individual).

### **Health Savings Accounts - More Popular**

Congress created a medical deduction similar to an IRA in that it allows us to claim a deduction for medical expenses above the line. It does require some extra steps that may be worth looking into.

It will allow you to deduct preventive care and over-the-counter medicine and supplies (i.e. Band-Aids and Aspirin). It does require you to have a medical insurance plan, either through your employer or purchased on your own, with a deductible of at least \$1,100 for an individual, \$2,200 for a family and is not available for those participating in Medicare.

The concept is to allow you to invest in an IRA like account (HSA). This amount is available for you to reimburse yourself for almost any medical expenses except for health insurance premiums. A number of insurance companies and banks have teamed up together to make these HSA's work smoothly. There are reporting requirements on your tax return, but that is easily taken care of if you make us aware that you are participating in an HSA.

The maximum amount one can contribute to an HSA is \$3,000 in 2009 (\$3,050 for 2010) for an individual or \$5,950 (\$6,150 for 2010) for a married couple. A positive aspect of this is that money contributed to the HSA can be carried over to future years with no limits, and if you turn 65 and begin participating in Medicare, you can withdraw the funds like an IRA. If, however, funds are withdrawn before age 65 for any purpose other than medical expenses, it is not only subject to tax, but also a 10% penalty as well.

Look at [www.hsainsider.com](http://www.hsainsider.com) for good information about HSA's including costs and deductibles of some specific plans. Compare the savings on the reduced premiums for your health insurance with the added cost you will be responsible for with the higher deductibles.

### **IRS Mileage Rate 2009**

The IRS mileage rate was adjusted down to 55 cents per mile in 2009. Medical and moving mileage was adjusted down to 24 cents per mile in 2009. Charitable

mileage remains at 14 cents per mile for 2009 as Congress did not allow for cost of living adjustments.

## IRS Audits & Notices

The IRS and many states are sending out a lot of notices trying to collect additional taxes. 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.

## Employee or Subcontractor?

Many of you own a business and hire subcontractors or pay commissions or rents during the year. We need to remind you that if you make payments totaling \$600 or more to any one person, attorney, or unincorporated business, you must prepare and file a 1099-MISC which must be filed with the IRS by the end of February. We believe this will be a major focus of the IRS **and we will be requiring you to issue these forms in order to claim the deduction on your returns in the future.** If you need assistance, give us a call.

## Foreign Bank Account Reporting

The IRS wants to keep closer tabs on foreign accounts of US taxpayers. There is a reporting requirement if you have \$10,000 or more in a foreign account. You must also file Form 90.22-1 by June 30 and submit a detail of your foreign accounts.

## 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 \$105,000 for a single individual (\$166,000 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 \$67,900 for a married couple in 2009 (\$33,950 for singles). Children under 18 can make \$1,800 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 \$5,450 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 for 2009 (\$26,000 for couples) per year to as many individuals as you desire. This provides a way to transfer assets to your children. You also have a combined lifetime estate and gift tax exemption up to \$3,500,000 in 2009, 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 different years, 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, 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.

**Sell real estate on the installment sale method** if you want to receive cash from the sale. Installment sales require only that you receive payment in at least two different years. You are taxed on the profit prorated by the cash received in each year. Be aware that in the year of sale, the IRS requires total payments to be reported, not the net cash you received. Also any depreciation recapture is taxed in full in the year of sale. One caveat to be aware of—if Congress changes the capital gains tax rules, all capital gains received after the date of the change will be taxed at the new rate.

**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 \$1-3,000 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 the 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 are only able to forward copies of tax returns to you because of stricter 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 know your current email address when you return your appointment card or the next time you call us if we do not currently have it on file or it has changed. You can reach us at the following email addresses:

Edyth Chung	(Appointments, status of returns)	<a href="mailto:Receptionist@clementcpa.com">Receptionist@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>

During tax season, Steven can take a while to return emails and has very limited time to return phone calls. Please email your tax questions to Pattie during tax season if you would like a quick response.

### **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 an interactive worksheet for Non-Cash Contributions 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.