

Client Newsletter

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More Tax Changes

The summer 2010 client newsletter discussed the tax changes found in four different statutes that had been signed into law up to that time. Since then, the “Small Business Jobs Act of 2010” was signed into law by the President. The major information services for tax professionals have listed 14 tax breaks in the new act, but most of them don’t apply to everyone. The following, however, are some key changes that apply to a number of our clients.

Section 179 Expensing for Qualified Real Property

The most misunderstood change is the widely publicized statement that “up to \$250,000 of qualified real property is eligible for Section 179 expensing in 2010 and 2011.” However, the fine print, so to speak, excludes residential rental property. This widely heralded break only applies to leasehold improvements to commercial property, restaurant buildings, and retail establishments.

Cell Phones Removed from “Listed Property” Category

Cell phones have finally been removed from the ‘listed property’ category. Users of ‘listed property’ are required to maintain records

of the amount of personal use as a percentage of total use. The most common example of that is automobiles used for businesses. Fortunately, if auto use is audited, the IRS normally permits the reconstruction of auto records, and those reconstructions have saved a lot of auto expense deductions.

Nevertheless, despite the tax law change, phone bills should be retained, either on paper or electronically, to be able to verify for an auditor that most of the phone calls are for business purposes. The mere fact that they are no longer ‘listed property’ doesn’t remove them from record-keeping requirements altogether.

Rental Property Owners Must Issue 1099-Misc Forms

Some people have thought that since renting real estate isn’t a trade or business for certain sections of the Internal Revenue Code, rental property owners shouldn’t have to file 1099 forms for amounts paid to service providers. That’s not true.

Congress has made it clear, with Internal Revenue Code section 6041(a), that for payments made after December 31, 2010, rental property owners are subject to

the same information reporting requirements as any other trade or business. So, any payments of \$600 or more made by a rental property owner to a service provider (such as a plumber, painter, or gardener) will have to be reported to the IRS on Form 1099-Misc.

The penalties for failing to do so have been increased for payments made after December 31, 2010. The penalties are categorized as to first-, second-, or third-tier penalties, a breakdown that just creates more

(continued next page)

Table of Contents

| Topic | Page |
|---|------|
| More Tax Changes | 1 |
| The Status of the Bush Tax Cuts | 2 |
| Estate Tax Update | 2 |
| Easy Year-End Tax Planning Advice | 2 |
| Identity Theft / Phishing Warning | 2 |
| Dispelling Rumors About Two Recent Tax Law Changes | 3 |
| Clearing Up Other Common Tax Misconceptions | 3 |
| Minimum Required Withdrawals from IRAs, 401(k)s, Keoghs, Pensions | 4 |
| IRA Custodian or Advisory Fees | 4 |
| Conversion of IRAs to Roth IRAs | 4 |
| A Bank Account for Your Business | 4 |
| Wills, Trusts, and Property Titles | 5 |
| Electronic Tax Organizers | 5 |
| Be Moving? Be Sure to Tell Us | 5 |
| Our Web Site and Newsletters | 5 |
| Laughter Is the Best Medicine | 6 |
| Appointments January - April | 6 |
| Quoted Again | 6 |
| Speaker Available | 6 |

More Tax Changes

(continued from page 1)

confusion. Generally, the penalties that will be levied on rental property owners for not complying are \$100 per 1099 that wasn't filed. It's actually more complicated than that, but the \$100 per 1099 figure should be enough to focus one's attention on complying.

For 2011 payments to independent contractors, a Form 1099-Misc doesn't have to be filed for payments to an incorporated independent contractor. However, for 2012 payments, that exception will be removed, and 1099-Misc forms will have to be filed for any payments to an independent contractor totaling \$600 or more per year, irrespective of whether or not that person is incorporated.

Estate Tax Update

Sadly, there's no information to report on the estate tax. Congress has shirked its responsibilities in this area. The estate tax will return for 2011, and exemption is set to be \$1 million—far less than the \$3.5 million that it had been for 2009.

Easy Year-End Tax Planning Advice

The best tax planning advice is to maximize any possible fully legal deferrals of income, such as one's contributions to 401(k), 403(b), 457, SEP, IRA, or Keogh plans. Because of the Internal Revenue Code's increased complexity and traps in the alternative minimum tax, old standbys like prepaying property taxes or state income taxes don't always work. That's why anyone contemplating those moves will have to schedule a year-end tax planning appointment or send projected year-end totals via email or fax.

The Status of the Bush Tax Cuts

As this newsletter is being written (early November 2010), there is no clear picture. The division of party strength shifted after the election, but the present Congress will remain in power until the election winners are installed in January 2011.

So we are laboring in a great field of uncertainty regarding what tax changes will be made at the end of this year. The November 5, 2010, issue of the *Wall Street Journal* said that President Obama is open to extending all Bush-era tax cuts for a year or two, regardless of family income. Five days later, in the subtitle of an article on page 4, the *Wall Street Journal* noted that top Democrats are open to the idea.

The November 5, 2010, issue of the *Wall Street Journal* identified the following additional items being considered:

- Raise the Social Security retirement age to 69.
- Scrap deductions on mortgages over \$500,000.
- Raise the gas tax by 15 cents per gallon.
- Repeal the alternative minimum tax.
- Cut defense spending by \$100 billion.
- Cut the federal work force by 10%.
- Cut farm subsidies by \$3 billion.

Forbes magazine called it "Tax Planning Amid Political Ruins."

Here are some tax provisions that expired on December 31, 2009, and won't apply to 2010 tax returns unless Congress extends them:

- Making charitable deductions directly from one's IRA.
- Required Minimum Distributions resume for 2010, unless Congress changes it between now

and December 31, 2010. See page 4 in this newsletter.

- Sales taxes for a new car purchase as an itemized deduction.
- Property tax deduction, in addition to the standard deduction, for up to \$1,000 for married-filing jointly.
- Election to deduct sales tax instead of state income tax as an itemized deduction.
- Unemployment compensation no longer excluded up to \$2,400.
- Tuition and related expenses deductible as an adjustment to income.
- First-time homebuyer credit up to \$8,000 expired November 30, 2009.
- School teacher deduction up to \$250 for classroom supplies.
- AMT (alternative minimum tax) reduced by non-refundable credits.
- COBRA benefits subsidized for laid off employees.
- The alternative minimum tax is scheduled to get worse for 2010 taxes compared to 2009 taxes, but the leaders of both parties, Republicans and Democrats, say that's not going to happen.



Identity Theft / Phishing Warning

Neither the Internal Revenue Service nor the California Franchise Tax Board contact people unannounced. So, for example, emails with a subject line such as "Your Federal Tax Payment Batch Has Been Rejected" should be ignored and deleted. This is an example of a common phishing or identity theft scam.

Dispelling Rumors About Two Recent Tax Changes

Any tax legislation has always produced misinterpretations or rumors. Now that we're in the Internet phase of life, those misapprehensions can and do spread like wildfire. Here are two items from the tax legislation enacted earlier this year that are causing a lot of undue consternation.

First, it is *not* true that the cost of employer-provided health insurance will be included in W-2 wages for 2011. That cost will be included on the W-2 as an information item only, *not as part of taxable wages*. In fact, since it has caused so much confusion and upset, the IRS released a notice that it will be optional for employers for 2011.

Second, the 3.8% 'sales tax' on the sale of a residence does not apply to every sale; it's considerably more complicated than it might appear. The 3.8% tax is part of the new Medicare tax being charged on investment income for single taxpayers with an adjusted gross

income of at least \$200,000 or married couples filing jointly with an adjusted gross income of at least \$250,000.

The sale of one's personal residence will be affected only if (1) the taxpayer's profit exceeds \$250,000 (single) or \$500,000 (married filing jointly) and (2) one's adjusted gross income, including the taxable part of the sale, exceeds the \$200,000/\$250,000 figure above.

Especially for younger homeowners, with so many of them being in a loss position on their homes, this isn't a major concern right now. For many widows or widowers, this won't be a problem because of the 'stepped up basis' that most of them have. That leaves plenty of others who have to determine if there is a problem in their situation. So, bottom line, this is something to be aware of, but not something that will affect everyone who sells a primary personal residence.



More IRS Audits Anticipated

The IRS is increasing the number of income tax return audits. The primary thing that auditors are looking for is unreported or under-reported income. But, as everyone knows, the Internal Revenue Code is loaded with booby traps, and the auditors are also looking for instances of people having stumbled into those.

IRS and Franchise Tax Board audits are based on their assessment, usually determined via computer evaluations, of the content of a tax return. The initiation of an IRS or FTB audit or examination is beyond our control. The fact that your return is selected for examination

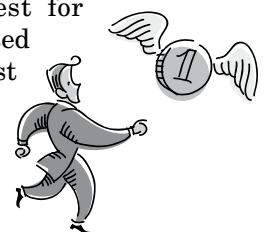
or audit does not mean that anything is wrong with it. Thus we charge for our services to represent clients in an audit.

Since these agencies ignore the costs incurred by the individual taxpayer being examined in these incursions, the costs of representation may far exceed the cost of having the original return prepared. However, if you think that the cost of representation is expensive, you should see how expensive the lack of representation can be.

Clearing Up Other Common Tax Misconceptions

The following is a short list of other common tax misconceptions.

- Vacation homes used solely for personal purposes don't qualify for Section 1031 exchanges.
- For California residents, the only California tax-free interest income is that from California State or other California governmental entities. For instance, the interest on a New York state bond will be tax-free for Federal income tax purposes but taxable for California income tax purposes. If looking to buy a tax-free municipal bond fund, be sure to buy one that is totally invested in California governmental entities if your goal is to have the income tax-free for California purposes. There are a few minor exceptions to this rule, but they're beyond the scope of this brief discussion.
- "Investment seminars" are generally not deductible, in spite of what the promoters say.
- Beware of email notices that purport to come from the IRS or Franchise Tax Board saying that they have a refund for you and asking for your Social Security number. Neither tax agency operates that way, and the email is probably a scam aimed at stealing your identity.
- Refinancing a rental to get money to buy a personal primary residence doesn't result in deductible interest for the increased loan against the rental.



Minimum Required Withdrawals from IRAs, 401(k)s, Keoghs, Pensions

Taxpayers must begin withdrawing from most types of pension, profit sharing, and IRA plans by April 1 of the year following the year in which they turn 70.5. Taxpayers didn't have to take a minimum required distribution for 2009, but those who turned 70.5 in 2010 will have to begin those withdrawals in 2010. They may postpone that until April 1, 2011, but then they'll have to take two distributions in 2011: one for 2010 and one for 2011.

The IRS may levy penalties for failing to take the minimum required withdrawal. It is usually best to begin in the year that one turns 70.5 because postponing it to the following year means that two with-

drawals must be taken that year. The impact of that could be moving into a higher tax bracket.

Computing the required withdrawal used to be complex, but the IRS has simplified the process and also lowered the amount that must be taken each year. To compute the minimum required withdrawal for any year, take the balance in the account as of December 31 of the prior year, then divide it by the applicable divisor from the table below. The divisor for other ages may be obtained by request from this office. (Use the December 31, 2009, balance for 2010 computations.)

| Age | Divisor | Age | Divisor |
|-----|---------|-----|---------|
| 70 | 27.4 | 80 | 18.7 |
| 71 | 26.5 | 81 | 17.9 |
| 72 | 25.6 | 82 | 17.1 |
| 73 | 24.7 | 83 | 16.3 |
| 74 | 23.8 | 84 | 15.5 |
| 75 | 22.9 | 85 | 14.8 |
| 76 | 22.0 | 86 | 14.1 |
| 77 | 21.2 | 87 | 13.4 |
| 78 | 20.3 | 88 | 12.7 |
| 79 | 19.5 | 89 | 12.0 |

Note: There is one booby trap. This isn't new; it's been around for years. Although the minimum required withdrawal from one's IRA accounts may be taken from a single IRA account, the required withdrawal from a 401(k), Keogh, or corporate pension plan may not be taken from an IRA account. It must be taken from one of the latter plans.

If you're about to begin your minimum required withdrawals, and you have had both deductible and nondeductible IRAs, we'll need to know how much was contributed to each. Also, there may be differences between what was deductible for IRS and what was deductible for California. So we need a history of your IRA deductions for federal and state purposes. Don't wait until the last minute to compile the information. Start now, and contact us if you're having trouble.



IRA Custodian or Advisory Fees

IRA custodian and/or advisory fees are deductible on Schedule A of one's Form 1040, but there are two catches. First, the fees must be paid via check or cash; if they merely are deducted from the account, they aren't deductible. (This first rule does not apply to non-IRA accounts.) The second one isn't new, and that is the fact that the fees are miscellaneous itemized deductions, and the total of one's miscellaneous itemized deductions must exceed 2% of one's adjusted gross income to be deductible.

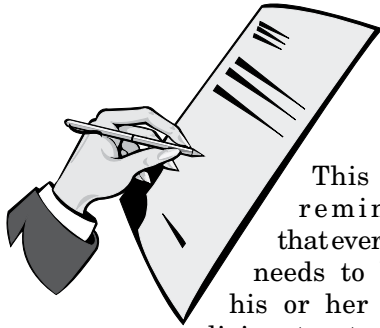
Conversion of IRAs to Roth IRAs

The conversion of IRAs to Roth IRAs was discussed on page 5 of the Summer 2010 client newsletter, which still is available on our web site (www.LWWilliams CPA.com). If you prefer, you may phone Paula Holcomb, the office administrator, and ask her to mail you a copy.



A Bank Account for Your Business

Are you starting a new business or forming an LLC, corporation, or partnership? By all means, open a new bank account in the name and tax identification number of the venture. When IRS audits a business, the fact that there's no separate business account weighs against the taxpayer and can result in the loss of the tax benefits sought via the LLC, corporation, or what-have-you.



This is a reminder that everyone needs to keep his or her will, living trust, joint tenancy designations, beneficiary designations, and property titles up to date.

An attorney is the proper person to write a will and/or living trust and also to give advice regarding property title forms. To have anyone other than an attorney write such documents or give advice in these areas falls into the same category as having golf pros do brain surgery.

If you don't have an attorney, we can give you the names of several with whom we've worked over the years. They all are bright and honest. Any referrals that we make are just that—referrals; we receive no kickbacks, finder's fees, or anything else other than freeing ourselves of headaches downstream when those documents have been prepared by amateurs instead of lawyers.

Wills, Trusts, and Property Titles

Horror stories abound of people who have been divorced for years, but estate documents still designate their ex-spouses as the beneficiary of their IRAs or as the joint tenant on the real estate, bank accounts, or stock brokerage accounts. Joint tenancy with right of survivorship (JTRWS) will override any other title form, living trust designation, or will. The property will pass to the person(s) designated as being the joint tenant(s) irrespective of any other legal document.

In a marriage, there generally is a tax benefit to the surviving spouse for appreciated property held in the title form of 'community property.' California added a new property form a few years ago of "Community Property with Rights of Survivorship." This has produced some unintended consequences so, once again, it isn't the quick-and-dirty answer to all situations.

The bottom line is see an attorney to get your estate planning documents done properly and/or updated.

Our Web Site and Newsletters

Send Us Your Ideas and Requests

Our newsletters often contain articles requested by our clients. If there's a subject you would like to see addressed on the web site or in future issues of the client newsletter, send your idea to Leonard at Williams@LWWilliams CPA.com or mail it to the office. Jokes are always welcome as well.

Articles of Interest from Previous Newsletters

You can obtain recent client newsletters by downloading them from our web site or by requesting them from Paula Holcomb at Holcomb@LWWilliams CPA.com.

View previous newsletters at www.LWWilliams CPA.com

Disclaimer

The information in our newsletters and web site is general in nature; no transaction should be completed without a professional consultation on its ramifications.

Please Pass It Along

Please pass this newsletter along to a friend or colleague when you have finished. You can also print it from our web site, send your friends or colleagues a link to the web site, or phone the office for an extra copy of the newsletter.



Electronic Tax Organizers

For the second year in a row, we will offer electronic tax organizers in January. This Windows-based program is a convenient way to fill in your organizer and email it back to your preparer.

If you would like an electronic tax organizer this year, please notify your preparer. You can email your preparer using his or her last name at our domain (for example, Williams@LWWilliams CPA.com). If you received an electronic tax organizer last year but don't want one again this year, let your tax accountant know that also.

Moving? Be Sure to Tell Us

Be sure to notify Paula Holcomb, the office administrator, of any change of address. She will send you the appropriate forms to sign and mail to the IRS and Franchise Tax Board.

Every once in a while, some poor soul winds up having a lien placed on his or her bank account by the tax authorities because correspondence went to the wrong address. Then it takes a lot of time and money to unravel the mess.



If we fix a hangnail the way our government fixes the economy, we'd slam a car door on it.

—Cullen Hightower



There will always be death and taxes; however, death doesn't get worse every time congress convenes.



I don't know jokes; I just watch the government and report the facts.

—Will Rogers



Politicians and diapers have one thing in common. They should both be changed regularly and for the same reason.



Politicians are the same all over. They promise to build a bridge even when there is no river.



Quoted Again

Leonard was quoted in the *Wall Street Journal* again. In the September 11, 2010, issue, Leonard was asked what question he is asked most commonly by his clients. The most frequently asked question he receives these days is whether the expiration of the Bush tax cuts affect 2010 or 2011 tax returns. The answer is 2011 returns.

Laughter Is the Best Medicine and Assorted Words of Wisdom

Hard work spotlights the character of people: some turn up their sleeves, some turn up their noses, and some don't turn up at all.

—Sam Ewig



Never be afraid to try something new. Remember, amateurs built the ark. Professionals built the Titanic.



The journey of a thousand miles begins with a broken fan belt and a leaky tire.



If you think nobody cares if you're alive, try missing a couple of car payments.

Seasons Greetings

We extend our greetings for the holiday season.

For the first time in more than 30 years, we will not be closed over the December holidays, although some staff members will be taking vacation time.



Appointments January - April

To accommodate clients in a timely manner, we pre-schedule tax appointments and notify you by mail. If the scheduled time is not convenient, please phone the office and we will gladly schedule something else. If you have a preferred time, please phone Paula Holcomb now and ask for it.

Yes, We're Taking New Clients

We're seeking additional clients this year. This business was built primarily by referrals, and your continued referrals are appreciated.

Speaker Available

Do you need a speaker for your civic, professional, or church group? Leonard Williams is a well known speaker on almost any tax subject. His most popular tax talk is an estate tax update in lay persons' language. Alternatively, Leonard has a slide show on his fire engine collection; over the years, groups have found that fascinating.

Note: Due to the demands of tax season, this service is generally available only from April 16 through the third week in January.

Storage Space Available

Leonard and a friend rent a warehouse to store their fire engines and surplus equipment. There is space available for antique autos, RVs, boats, etc. If you are interested, contact Cliff Smith at (408) 559-4842 or CliffSmith1@yahoo.com.