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## Tax & Business Issues Winter 2010

### 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.

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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.

Please contact our Tax Department if you believe you are a candidate for deduction planning.

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.

## Upcoming Events

### Webcasts for Nonprofits

Thursday, December 16  
1:00pm EST  
2010 Year End Planning  
Dave Moja, Instructor

**See our website to register!**

### 2011 Annual Nonprofit Seminar (IN)

Friday, March 11  
Anderson, Indiana

**See our website to register!**

### Higher Education Roundtables

Tuesday, March 1  
Columbia International University  
Columbia, SC

Tuesday, March 22  
Dallas Theological Seminary  
Dallas, TX

Wednesday, March 23  
Fuller Theological Seminary  
Pasadena, CA

Thursday, March 24  
Vanguard University  
Costa Mesa, CA

Tuesday, April 5  
Northern Baptist  
Theological Seminary  
Lombard, IL

**Stay tuned for details.**

## Maximizing Available Credits. It's All About Strategy!

There are a number of credits that can help reduce your tax bite for 2010. Unlike a deduction (which reduces your taxable income and thus provides a benefit equal only to the deduction amount times your tax rate), a tax credit is a dollar-for-dollar reduction of your tax. For some credits, such as the Earned Income Tax Credit, Child Tax Credit, Child and Dependent Care Credit, and others, there's not much you can do to change the outcome. However, there are some credits, described below, that offer year-end tax planning opportunities.

**Maximize Education Credits** - If you have a child in college for whom you claim a dependent exemption and you or someone else is paying the tuition for that child, you probably qualify for either the American Opportunity Credit or the Lifetime Learning Credit. The credits begin to phase out for higher-income taxpayers whose modified adjusted gross income is \$80,000 or more (\$160,000 for married couples filing a joint return).

- **American Opportunity Credit** - Maximum credit is obtained from \$4,000 of tuition and qualified expenses that provides a credit up to \$2,500 (100% of the first \$2,000 and 25% of the balance). Under normal circumstances, education credits are non-refundable; that is, they offset only a taxpayer's tax liability. However, for this credit, up to 40% can be refundable.
- **Lifetime Learning Credit** - Maximum credit is obtained from \$10,000 of tuition and qualified expenses that provide a 20% credit up to \$2,000.

If you have not already paid the maximum expenses for the year, it may be appropriate for you to prepay certain expenses that apply to the first quarter of 2011. The laws generally allow you to prepay tuition for an academic period that begins during the first three months of the next tax year, and then you can claim the prepaid amount for the current year's credit.

Please contact one of our offices for additional information on this tax strategy or other issues relating to education tax benefits and credits.

**Take Advantage of the Home Energy Property Tax Credit** - 2010 is the final year to take advantage of the "Home Energy Property Credit" that provides a tax credit for energy-saving improvements made to a taxpayer's principal residence. The credit is limited to \$1,500 (30% of up to \$5,000 of qualified expenditures) for improvements made in 2009 and 2010. So, if you claimed this credit in 2009, the most you can claim for energy-property improvements for 2010 is the \$1,500 maximum less any amount claimed in 2009.

Qualified improvements (those certified by the manufacturer to qualify for this credit), the use of which must originate with the taxpayer, must have a reasonable expected life of at least five years, and include:

- Energy-Efficient Exterior Windows and Skylights
- Energy-Efficient Exterior Doors
- Energy-Efficient Metal Roofs with appropriate pigmented coatings
- Energy-Efficient Asphalt Roofing with appropriate cooling granules
- Energy-Efficient Heating System
- Energy-Efficient Air Conditioning Systems and
- Insulation Materials or Systems designed to reduce heat loss or gain

## We Can Help!

The staff at CapinCrouse LLP works with hundreds of churches and not-for-profit organizations. This experience base allows us to quickly identify areas for improvement in many organizations. If your organization desires to improve its efficiency, please contact your Capin Crouse representative or one of our offices to discuss how we may help you.

## About CapinCrouse LLP

With more than 700 not-for-profit organizations and 1,500 tax clients, CapinCrouse is the country's leading accounting and advisory firm primarily serving the Christian not-for-profit community.

Since 1972, CapinCrouse has been serving not-for-profit entities including megachurches, institutions of higher education and secondary schools, and international missions agencies by providing a full range of audit, review, tax, and advisory services.

CapinCrouse is dedicated to helping our clients operate with financial integrity so that they can dedicate themselves to fulfilling their mission.

Credit is not allowed for onsite preparation, assembly, or installation of the component. It is a non-refundable personal credit; thus, the credit can be used only to bring your tax (including the alternative minimum tax) down to zero. Any excess is not refundable and cannot be carried over to a subsequent year.

**Pick a Hybrid or Lean-Burn Vehicle** - If you are planning to purchase a new automobile before the end of the year, it might be appropriate to purchase either a hybrid or lean-burn vehicle. Credits for these types of vehicles range from \$900 to \$2,350. However, this credit has phased out for most manufacturers and is currently available only on qualified vehicles manufactured by General Motors, Chrysler, Nissan, Mazda, BMW, and Mercedes for hybrid vehicles, and by Volkswagen, Audi, and Mercedes for qualifying lean-burn vehicles.

This credit is a non-refundable personal credit, which means it can reduce your tax only to zero, and any balance is lost. However, if the vehicle is used partially for business, the portion of the credit attributable to business use becomes a general business credit, and any amount not used in 2010 carries back one year and forward for 20 years until used up.

Please contact one of our offices if you have questions about how any of these credits will impact your specific circumstances.

## 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

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Los Angeles  
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**407.883.4671**

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**858.638.7220**

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 59½, 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 contact our Tax Department so we can help you properly analyze your conversion and contribution options.

## **Tax-Saving Strategies for Capital Gains**

One of the greatest benefits of the tax code is the special tax rates that currently apply to gain recognized from the sale of capital assets held for more than a year (long-term). The special tax rates apply to virtually all capital assets including land, improved real estate, your main and vacation homes, and business assets in excess of the accumulated depreciation previously deducted. These special long-term capital gains (LTCG) rates for 2010 are 0% (yes, that's correct, zero) to the extent your regular tax rate is in the 15% or 10% brackets, and 15% for most other capital gains. These rates also apply for the alternative minimum tax. The following are some issues and strategies that you may find of interest before year's end.

Historically, the end of the year has been a good time to plan tax savings by carefully structuring capital gains and losses. Conventional wisdom has always been to minimize gains by selling "losers" to offset gains from "winners" and, where possible, generate the maximum allowable capital loss of \$3,000 (\$1,500 for married taxpayers filing separately) for the year.

Assets that are not held long-term, referred to as short-term capital gains (STCG), do not receive benefits of the special rates afforded long-term capital gains. Taxpayers achieve a better overall tax benefit if they can arrange their transactions to offset short-term capital gains with long-term capital losses.

For those who would benefit from the zero LTCG rate in 2010, it may be appropriate to sell assets and create long-term capital gains to the extent that those gains would be taxed at the zero rate. However, this is a balancing act since LTCG also increases your income, which may push you into a higher tax bracket. Of course, you can also use losses to offset the gains and, contrary to conventional strategy, you should have only enough losses to keep the gain within the zero tax rates. If your income is too high to take advantage of the zero tax rates, then continue to employ the conventional strategies discussed above.

If you exercised incentive (qualified) stock options with your employer this year and you are still holding the stock, it may be appropriate to sell the stock before year's end to avoid phantom income created by the alternative minimum tax.

If you are planning substantial gifts to charity or to relatives and have capital assets that have appreciated in value, gifting the appreciated assets rather than cash may be beneficial.

The actions mentioned above may have additional factors to be considered and require careful planning. You are encouraged to consult with us before acting on any of the suggested strategies.

## Stay Compliant!

### Rental Owners Hit with New 2011 Reporting Requirement

If you are a rental owner and make payments of \$600 or more during 2011 to a service provider (such as a plumber, painter, or accountant) in the course of earning rental income, the 2010 Small Business Jobs Act says that you are required to provide an information return (typically Form 1099-MISC) to the IRS and to the service provider. To do so, you must obtain the payee's name, SSN, and contact information before making a payment. The IRS provides Form W-9 for that purpose.

There is a "Catch-22" you need to watch out for. Suppose you call a plumber and pay him \$400 for a service call at your rental property and don't bother to have him complete and sign a W-9 since the amount is under \$600. Then, later in the year, you need him again and pay another \$400 for the second service call at the rental, and again fail to obtain the completed W-9. Now, you have a 1099 filing requirement but do not have the information needed to file the information returns in 2012. If the plumber can't be found, you are left holding the bag. Moral of this story: Always collect a completed W-9 from the payee before paying him!

What happens if you don't meet your filing obligation? Well, there are monetary penalties! As part of the 2010 Small Business Act, the penalties are doubled for information returns required to be filed after 2010. So, if you are 30 days late filing the information return with the IRS or furnishing a copy to the payee, you are subject to a \$30 per-payee penalty. If returns are more than 30 days late but filed by August 1, the penalty per payee is \$60; if filed after August 1, the penalty jumps to \$100 per payee.

The penalties can be substantial, and you are cautioned to establish a procedure for obtaining W-9s from your service providers before the beginning of 2011. Note: Payments to incorporated businesses and those made for the purchase of merchandise are not included in these requirements until 2012.

Please contact our Tax Department if you need assistance.