tax& financial UPDATE

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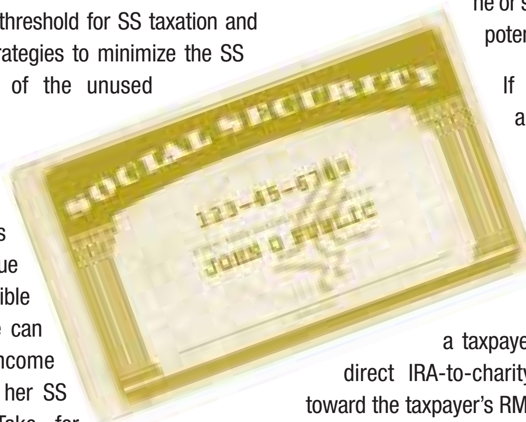
SILKMAN & ASSOCIATES ACCOUNTANCY CORPORATION

Manage the Tax on Your Social Security Benefits!

Social Security (SS) income is not taxable until a taxpayer's AGI (without Social Security income) plus 50% of his or her Social Security income plus tax-exempt interest income, and certain other infrequently encountered additions exceed a specific threshold. The threshold is $32,000 for married taxpayers filing jointly, zero for married taxpayers filing separately and $25,000 for all others. Once the threshold has been exceeded, the Social Security income subject to tax varies from 50% to 85%.

Few taxpayers understand this threshold for SS taxation and make no attempt to employ strategies to minimize the SS taxability or take advantage of the unused threshold amount.



If a taxpayer's only income for the year is from Social Security, then there is no tax on this income. However, if that is true and the taxpayer has other possible source(s) of income, she or he can actually take in additional income without causing any of his or her SS income to become taxable. Take, for example, a 68-year-old single individual with an annual SS income of $18,000. The threshold for single individuals is $25,000. Subtracting the SS income from the $25,000 leaves a $16,000 difference. That is an additional $16,000 of income, taxed at the lowest possible rates, the taxpayer could have had that year without causing any of his or her SS benefits to become taxable. For 2011, a single individual age 65 or older is entitled to a standard deduction of $7,250 and an exemption of $3,700. Thus, in our example, if the taxpayer had an IRA and took a distribution from it of $16,000, he or she would have been taxed only on $5,050 ($16,000 - $7,250 - $3,700), and the tax would have been a minimal $505 because he or she is in the lowest possible tax bracket, 10%. Result; the taxpayer avoided having any of his or her SS income taxed and was able to withdraw $16,000 from his or her IRA with a tax of only $505, which is only a 3.2% tax.

If that same taxpayer had been saving his or her IRA for beneficiaries to inherit, then he or she just saved them a lot of money, because they would be taxed on the IRA based on their tax rates, which would, no doubt, be higher. They can inherit the bank account in which the taxpayer put the distribution without any tax (assuming the total value of his or her estate is under the estate tax exemption amount for his or her year of death). He or she also reduced his or her IRA value, so that when he or she reaches the 70½ mandatory distribution age, he or she will not have to take out as much, potentially again reducing the tax.

If a taxpayer is 70½ years of age or over, she or he is required to start taking required minimum distributions (RMD) from IRAs and most other retirement plans. The amount of the RMD can impact the taxation of the taxpayer's Social Security benefits. For 2011, a taxpayer aged 70½ and over can make a direct IRA-to-charity distribution, which also counts toward the taxpayer's RMD for the year. The distribution is not included in income (therefore, does not impact the taxability of the Social Security) and the charitable contribution is not deductible, since the distribution from which the contribution was made is not includable in the income for the year.

An added benefit is when a taxpayer has a substantial charitable contribution and he or she only marginally itemizes. Donations to charities are tax deductible only when a taxpayer itemizes deductions. By replacing the RMD income and charitable contribution with a direct IRA-to-charity rollover, the taxpayer has the satisfaction of contributing to a favorite charity while, at the same time, being able to exclude the distribution from income and utilize the standard deduction to reduce his or her tax bite.

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.

Your Broker's **1099 Statement Will Be Different for 2011**

For years, the IRS has had the ability to identify the gross sales of taxpayers from broker transactions, including security (reported on 1099-B forms) and property sales (reported on 1099-S forms). However, these identified only the sales price, quantity sold (for securities), and dates of the transactions. To determine the profit or loss, you must also know the tax basis of the property that was sold. Without confirmation of the basis, which, up to now, has been obtainable only from the taxpayer via an audit, the IRS has no way to verify the reported profit or loss from the sale, leaving this area open to abuse.

That will be changing starting in 2011, at least for security sales. Beginning in 2011, every broker who is required to file an information return reporting the gross proceeds of a security must include in the informational return the customer's adjusted basis in the security and whether any gain or loss with respect to the security is short-term or long-term.

Securities initially covered under this new requirement include: (a) shares of stock in a corporation, (b) notes, bonds, debentures, or other evidence of indebtedness and (c) commodities, contracts, or derivatives with respect to the commodities.

The requirement is being phased in and will generally apply to:

- Corporation stocks acquired after 2010,
- Regulated investment companies (mutual funds) and dividend reinvestment plans after 2011,
- Certain other securities (as determined by the IRS) after 2012.

The IRS estimates that more than one in three taxpayers who sold securities may have misreported capital gains and losses – in many cases, because they misreported their basis – and it expects the new basis reporting rules to go a long way toward correcting that problem. However, since the effective dates for broker basis reporting will be based on the acquisition dates of the securities, there will still be many sales in the years to come for which brokers may not report the basis because they lack the information. For these sales, the basis of the securities that were sold will need to be determined by taxpayers, as in the past.

Under this new reporting requirement, the gain or loss reported by a brokerage firm will be based on a first-in first-out (FIFO) method unless the customer notifies the broker by means of making an adequate identification of the stock sold or transferred. In the case of securities where the "average cost basis" method is allowable, brokerage firms are to use the "average cost basis" method unless customers notify brokers that they elect another acceptable method with respect to the account in which the stock is held.

This is a complicated undertaking and, undoubtedly, there will be some confusion in terms of matching basis with transactions. For example, under these new rules, a customer's adjusted basis is determined without regard to the wash sale rules unless the transactions occur in the same account. This will create basis-matching problems where identical securities are held in other accounts.

If you have questions related to these new broker reporting requirements and how they might affect you, please give this office a call.

Tax Perks For the **Business Traveler**

Food and lodging expenses may be deducted when you are away from home for business purposes. There are certain rules to follow and the individuals who know the rules and keep good records get the most out of these deductions.

The IRS requires that lodging expenses (and other expenses of $75 or more) be substantiated by records or other evidence. Acceptable records include diaries, logs, receipts, paid bills, and expense reports. The records should disclose the amount, date, place, and essential character of the expense. The following are some tips to help you stay on top of the required documentation:

- Keep good records of travel expenses.
- Maintain the records on a contemporaneous basis, i.e., make diary and log notations close to the time the expense is incurred.
- Document the business purpose and the expected business benefit.
- Retain your travel itinerary to document the business activity while away.

Travel expenses are deductible only if the individual is away from his or her "tax home"– usually considered to be one's regular place of business – for more than one business day.

Meal expenses are deductible only if the trip is overnight or long enough that there is a need to stop for sleep or rest to properly perform one's duties. The amount of the meal expenses must be substantiated, but instead of keeping records of the actual cost of meal expenses, a "standard meal allowance" ranging from $46 to $71 can generally be used, depending on where and when the individual travels. Generally, the deduction for unreimbursed business meals is limited to 50% of the cost that would otherwise be deductible.

Lodging expenses must be substantiated with receipts and are 100% deductible. Meals included in lodging expenses, such as room service or dining costs charged to a hotel room, must be separately identified, since meals have the 50% limitation, as noted.

In addition to the travel, lodging, and meal expenses discussed, the incidental costs incurred on a deductible trip such as laundry, dry cleaning, phone calls, baggage handling, and so on are fully deductible.

Employees must deduct their unreimbursed travel expenses as a miscellaneous itemized deduction, which is subject to a 2% of AGI floor. They are not deductible at all to the extent that the employee's income is subject to the alternative minimum tax (AMT). That is why it is to an employee's advantage to utilize an employer's "accountable" reimbursement plan (under which qualified reimbursements are not taxable and not reported in the employee's W-2 wages) rather than deducting the expenses on his or her tax return. On the other hand, these expenses are fully deductible as a business expense for a self-employed individual.

Taking the spouse along? Generally, deductions are denied for travel expenses paid or incurred for a spouse, dependent, or employee of the taxpayer who accompanies the taxpayer on the business trip unless the:

(1) Spouse or dependent is an employee of the taxpayer, and

(2) Travel of the spouse, dependent, or employee is for a bona fide business purpose, and

(3) Expenses would otherwise be deductible by the spouse, dependent, or employee.

Strategy – The law allows a deduction for the single rate for lodging, and frequently there is no rate difference between one or two occupants. Thus, the entire lodging expense for a spouse will be deductible. When traveling by car, the law does not require any allocation because the spouse is also traveling in the vehicle. Thus, if you are traveling by vehicle, the entire cost of the transportation would be deductible. That would generally also apply to taxis at the destination. The only substantial cost that is not allowed is the cost of the spouse's meals, which, even if they were deductible, would be reduced by the 50% rule. If traveling by air or rail, the cost of the spouse's tickets also would not be deductible.

Please give this office a call if you have questions related to business travel expenses.

Getting Older With **No Retirement Savings in Sight?**

One of the earliest lessons in life is that actions have consequences, and approaching retirement age without a substantial nest egg is one of those consequences. If you are in this situation, you are not alone, as millions of other Americans are faced with the same need to save enough to retire comfortably.

Our priorities shift throughout our lives. Early in the life cycle, home ownership is a priority; that is usually followed by raising and educating children. However, as retirement approaches, the focus needs to shift toward retirement funding. By the time most people are 45 or 50, their children are on their own, the mortgage is close to being paid off, and there is more discretionary income to set aside for retirement.

If you are starting to think about retirement, there are three pitfalls you need to avoid: (1) Retiring on your birthday instead of your bank account, (2) not properly managing your risk and (3) retiring with too much debt.

A frequently asked question is *How much do I need to put aside for retirement?* The answer to that question varies with each individual. There a number of factors to consider: current income, existing savings, assets, how many years until you plan to retire, the lifestyle you want in retirement, and what you can afford to put aside.

If you want to make a rough estimate of the savings needed, determine your approximate income needs and calculate the amount of money you will receive, aside from your savings. These other sources could be your Social Security benefit, a pension, or an IRA or a 401(k) plan.

Add up all of the funds that will come from your Social Security benefit, pension, etc., and determine a savings goal that will, after retirement, provide the additional income needed for retirement. Be sure to factor in inflation and a reasonable rate of return, taking into consideration today's tough economic environment. Also consider your existing savings and assets that help to fund retirement.

Then start figuring out how to make up for the difference. Here are some suggestions:

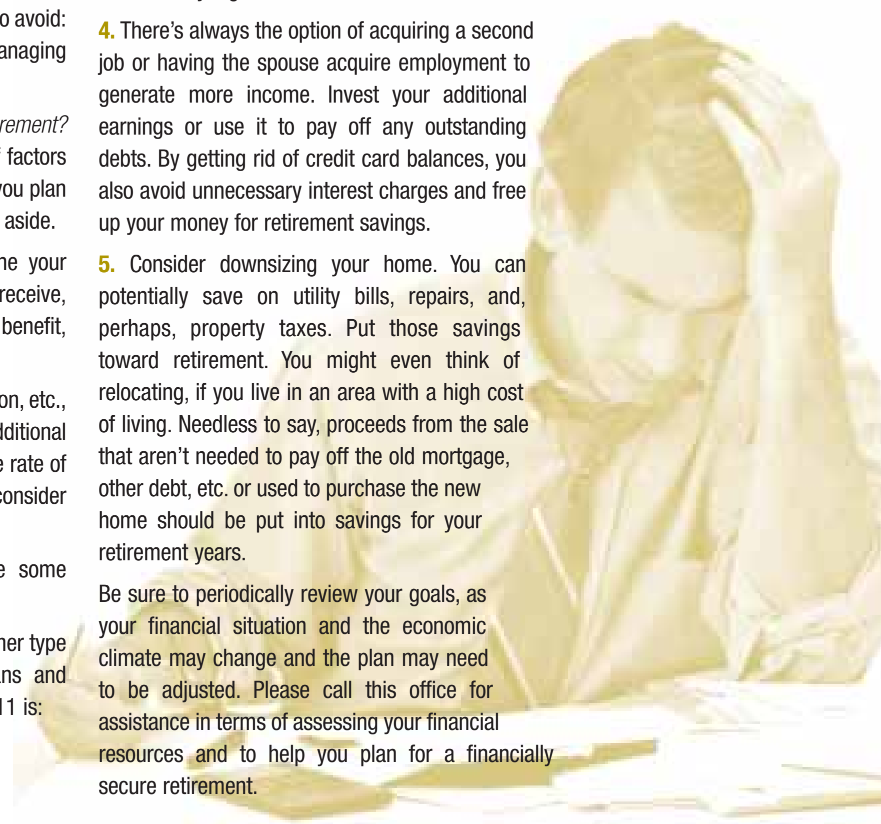
1. Check to see whether your employer offers a 401(k), a 403(b), or some other type of voluntary contribution retirement plan. Take advantage of these plans and contribute the maximum you can afford up to the annual limit, which for 2011 is:

- $16,500 for taxpayers below 50 years of age, and
- $22,000 for taxpayers 50 years of age and over.

The contribution is before taxes, so making the contribution will lower your gross income and reduce your current tax bite. Also, if your employer matches a percentage of your contribution, that is free money for you.

2. If you have earned income (or receive alimony) but don't have an employer plan to contribute to or if you can afford to set aside additional funds, you might consider an IRA. Here, you have a choice between a traditional IRA and a Roth IRA. Traditional IRA contributions can be tax deductible or not, depending on your income and whether you have an employer retirement plan. Roth IRAs are not tax deductible, but accrue earnings tax free. However, contributing to a Roth IRA can be complicated for higher income taxpayers. The IRA contribution limit for 2011 is $5,000 ($6,000 if age 50 and over). In some cases, a spouse can also contribute to an IRA based on the other spouse's earned income.

3. Self-employed individuals can take advantage of a variety of available defined contribution retirement plans that allow contributions nearing 20% on the self-employed individual's net income, limited to a maximum of $49,000 for 2011. There are also more complicated defined benefit plans available that allow substantially higher contributions.



4. There's always the option of acquiring a second job or having the spouse acquire employment to generate more income. Invest your additional earnings or use it to pay off any outstanding debts. By getting rid of credit card balances, you also avoid unnecessary interest charges and free up your money for retirement savings.

5. Consider downsizing your home. You can potentially save on utility bills, repairs, and, perhaps, property taxes. Put those savings toward retirement. You might even think of relocating, if you live in an area with a high cost of living. Needless to say, proceeds from the sale that aren't needed to pay off the old mortgage, other debt, etc. or used to purchase the new home should be put into savings for your retirement years.

Be sure to periodically review your goals, as your financial situation and the economic climate may change and the plan may need to be adjusted. Please call this office for assistance in terms of assessing your financial resources and to help you plan for a financially secure retirement.

Are Charity Auction Purchases **Deductible Contributions?**

It is common practice for charities to hold auction events at which attendees bid on and purchase items. The question often arises as to whether the money spent on the items purchased constitutes a charitable donation.

The answer is that some, but not all, of what you paid for the item may be deductible. Donors who purchase items at charity auctions may claim a charitable contribution deduction for the excess of the purchase price paid for an item over its fair market value. The donor must be able to show, however, that he or she knew that the value of the item was less than the amount paid. For example, a charity may give a catalog to each person who attends an auction that provides a good faith estimate of the value of items that will be available for bidding. Assuming that the donor has no reason to doubt the accuracy of the published estimate, if he or she pays more than the published value, the difference between the amount paid and the published value may constitute a charitable contribution deduction.

In addition, donors who provide goods for charities to sell at an auction often ask the charity whether they are entitled to claim a fair market value charitable deduction for a contribution of appreciated property to the charity that will later be sold. Under these circumstances, the law limits a donor's charitable deduction to her or his tax basis in the contributed property and does not permit the donor to claim a fair market value charitable deduction for the contribution. Specifically, the Treasury Regulations (Sec 170) provide that if a donor contributes tangible personal property to a charity that is put to an unrelated use, the donor's contribution is limited to the donor's tax basis in the contributed property. The term "unrelated use" means a use that is unrelated to the charity's exempt purposes or function. The sale of an item is considered unrelated, even if the sale raises money for the charity to use in its programs.

If you have questions related to charity auctions, please give this office a call.

YOU ASKED: With interest rates so low, I am considering refinancing my original home loan. Are there any tax ramifications I should be concerned about?

ANSWER: Since this is the first time you have refinanced the loan and as long as you don't take any cash out, the interest will continue to be fully deductible, provided the loan does not exceed $1 million. This is true even if you extend the term of the loan. However, if you take out some cash (i.e., the new loan amount is greater than the principal balance of the old loan), then the interest on the first $100,000 of the cash taken is treated as equity debt interest, and, although deductible for regular tax, it is not deducible to the extent that you are subject to the alternative minimum tax.

YOU ASKED: My wife and I purchased a home in 2008; we received a first-time homebuyer credit and made our first installment of repayment on our 2010 tax return. However, we are divorcing, and my spouse is getting the home in the divorce. Am I still liable for the credit repayments?

ANSWER: The 2008 credit was essentially an interest-free loan that must be paid back in installments over a 15-year period unless the home is sold, at which time the entire credit must be paid back, but the accelerated payback is limited to gain from the sale of the home. When, as your case, the home is transferred to one of the spouses as her or his separate property incident to divorce, the accelerated recapture rule does not apply to the transfer, but both the regular and accelerated recapture rules apply to the transferee spouse – in your case, your wife – who will be responsible for any future recapture payments. The transferor spouse – you – has no further repayment obligation.

• Certified Public Accountants
• Business Managers
• Real Estate

taxcalendar September – December 2011

September – December

– Time for your 2011 and 2012 Tax Planning. Contact this office to schedule a consultation appointment.

September 15, 2011

– The third installment of 2011 individual estimated taxes is due.

– This is the FINAL extended filing due date for your 2010 calendar year partnership returns (Form 1065), fiduciary returns (Form 1041), S corporation returns (Form 1120S), and corporation returns (Form 1120).

October 17, 2011

– This is the FINAL extended filing due date for your 2010 individual income tax return.

December 31, 2010

– Last day for taxpayers who began their minimum IRA distributions in a year before 2011 to make their required withdrawals for 2011. As Dec. 31st is a Saturday in 2011, to allow IRA trustees/custodians ample time to process distribution payments, taxpayers should request distributions well ahead of this date.

– This is generally the LAST day that you can pay tax-deductible expenses for the year. IRA contributions and some self-employed retirement plan contributions can be made after the close of the year.