January/February 2010

tax IMPACT

Extra credit
Do your homework on the Work Opportunity tax credit

Until death ...
Postmortem strategies to reduce estate taxes

See the big picture
A holistic approach to tax planning

Tax Tips
Shareholder loans, job search expenses and Roth IRA conversions

Dunbar, Breitweiser & COMPANY, LLP

CERTIFIED PUBLIC ACCOUNTANTS
202 North Center Street
Bloomington, Illinois 61701-3995
Phone 309-827-0348
Fax 309-827-7858
www.dbc-llp.com

Extra credit

Do your homework on the Work Opportunity tax credit

In today's tough economy, every dollar counts. But many businesses lose out on thousands of dollars in tax savings every year by failing to claim tax credits to which they're entitled. One such overlooked credit is the Work Opportunity tax credit (WOTC).

The WOTC is a dollar-for-dollar reduction in federal tax liability — ranging from $1,200 to $9,000 per new hire — for companies that hire people from disadvantaged groups, including certain youth, public assistance and veterans recipients.

The maximum WOTC is available for employees who work 400 hours or more during their first year of employment.

Know which employees are eligible

The credit's requirements are detailed and specific. Generally, new hires who belong to one of these groups qualify:

- Short- and long-term recipients of Temporary Assistance for Needy Families (TANF) benefits,
- Veterans who are disabled or unemployed, or receive food stamps,
- Ex-felons hired within one year after conviction or release from prison,
- Individuals age 18 to 39 who live in empowerment zones, enterprise communities or renewal communities ("designated communities"),

- Disabled individuals referred after completion of a qualified vocational rehabilitation program,
- Summer youth employees age 16 and 17 who live in designated communities and work at least 90 days between May 1 and Sept. 15,
- Individuals age 18 to 39 who receive food stamps,
- Individuals receiving Supplemental Security Income (SSI) benefits, and
- "Disconnected youth" age 16 to 24 who aren't in school, employed or readily employable due to a lack of basic skills.

Each target group is subject to specific requirements, so it's important to do your homework to see whether any of your new hires qualify. For example, short-term TANF recipients must have received benefits for at least nine months during the 18-month period ending on the hire date. Also, unemployed veterans must have been discharged from active duty within five years before the hire date and have received unemployment compensation for at least four weeks during the one-year period ending on the hire date.

Determine savings

Generally, the credit reduces the employer's wage deduction dollar-for-dollar. The reduction is required even if you can't take the full amount of the credit in the current year and must carry it back or forward.

For most targeted groups, the maximum credit is 40% of first-year wages up to $6,000 (a maximum credit of $2,400). For disabled veterans, the maximum credit is 40% of first-year wages up to $12,000 (a maximum credit of $4,800). And for summer youth employees, the maximum credit is 40% of first-year wages up to $3,000 (a maximum credit of $1,200).

For long-term TANF recipients, the maximum credit is 40% of first-year wages up to $10,000 (a $4,000 credit), plus 50% of second-year wages up to $10,000 (a $5,000 credit, so there's a maximum credit of $9,000 over a two-year period). Formerly known as the welfare-to-work credit, this credit was combined with the WOTC a few years ago.

The maximum WOTC is available for employees who work 400 hours or more during their first year of employment. A partial credit equal to 25% of qualifying wages is available for those who work between 120 and 399 hours.

Worth the effort

To obtain the WOTC, you first need to complete and file various federal forms when hiring a qualifying employee. Once the employee has worked the required number of hours, you can claim the credit on your company's next income tax return. You also may be eligible for state credits or other incentives. Your tax advisor can help guide you through the process. Although it's complicated, the tax savings can be well worth the effort. ◎

Until death …

Postmortem strategies to reduce estate taxes

Do you worry about having an estate plan that won't meet all of your objectives? You're not alone. With ever-changing estate tax laws and the possibility that other unexpected situations may arise, it's not unusual to be concerned about the strength of your estate plan.

But you can ease your worries a bit by remembering that there are a number of strategies your surviving spouse, executor or beneficiaries can implement after your death to save estate taxes.

Strategies for married couples

To discourage people from disinheriting their spouses, most states' laws give surviving spouses a right of election that allows them to circumvent the will and take an elective share of certain property. The share varies from state to state: It may be a set portion of the property, such as one-third or one-half, or the percentage may increase with the length of the marriage. Because a spouse's elective share of property qualifies for the marital deduction, exercising the election can be an effective way to reduce estate taxes.

If your estate plan includes a qualified terminable interest property (QTIP) trust, another postmortem tax-saving option may be available. A QTIP trust can be an effective way to provide income to the surviving spouse while preserving assets

for other beneficiaries, such as children from a previous marriage. For the transfer of assets to the trust to qualify for the marital deduction (and thus not be included in the taxable estate of the first spouse to die), several requirements must be met, including these:

- The trust assets must, at the insistence of the surviving spouse, be invested in income-producing property.
- All of the trust income must be distributed to the surviving spouse at least annually.
- A QTIP election must be made on the estate tax return.

Ultimately, QTIP trust assets are subject to tax as part of the surviving spouse's estate. In some cases, though, including more assets in the estate of the first spouse to die can minimize the overall estate tax. This might be the case if the first spouse has fewer assets than his or her available estate tax exemption. In such a situation, the deceased spouse's executor may decide not to make the QTIP election or to make only a partial QTIP election.

Qualified disclaimers

A qualified disclaimer is an irrevocable refusal to accept an interest in property from a will or living trust. Under the right circumstances, a qualified disclaimer can be used to redirect property to other beneficiaries in a tax-efficient manner.

For example, Joanna's will leaves her entire estate to her son or, if he predeceases her, to her grandchildren. At Joanna's death, if her son doesn't need all of the money, he can file a qualified disclaimer with respect to a portion of it. The remaining assets will then pass directly to Joanna's grandchildren. Assuming that the disclaimed property is protected by Joanna's generation-skipping transfer (GST) tax exemption, the disclaimer allows her family to avoid the gift or estate taxes that would have been owed had her son received the property first.

To qualify, a disclaimer must be in writing and delivered to the appropriate representative, generally within nine months after the transfer is made and before the disclaimant accepts the property or any of its benefits. Keep in mind that the disclaimant has no power to determine who will receive the property. Rather, the assets must pass according to the terms of the underlying document making the transfer — such as a will, living or testamentary trust, or beneficiary form.

Under the right circumstances, a qualified disclaimer can be used to redirect property to other beneficiaries in a tax-efficient manner.

Valuation options

Property typically is valued as of the date of death for estate tax purposes. But an executor may elect to use the alternate valuation date, which is six months later. This date can be used only when it results in a lower estate tax bill and, therefore, is typically elected when the value of property has declined.

Note that the election is irrevocable and can't be applied selectively to certain property. Once the election is made, it applies to all of the estate's property (except for property disposed of during the six-month period).

If a significant portion of the estate consists of real property used in a family business or farm, another valuation option may be available: a special-use valuation. The executor can elect to value the property based on its actual use, rather than its "highest and best use," reducing estate taxes.

Several requirements must be met to qualify for a special-use valuation. For example, "qualified heirs" must materially participate in the operation of the business or farm for at least 10 years after the decedent's death.

Keeping abreast of changes

There are many complexities and unpredictabilities in estate planning. Fortunately, a number of effective estate planning strategies can be implemented after death. Nevertheless, reviewing your estate plan regularly and updating it in light of changes in tax law, your personal circumstances or your family is the best way to realize your estate planning goals. Your tax advisor can keep you abreast of the latest estate tax law changes. ◎

See the big picture

A holistic approach to tax planning

For many people, tax planning is something they don't begin to think about until December. During the year, they concentrate on running their business and managing their investments. Then, late in the year, they make a series of last-minute moves — such as accelerating expenses, deferring income or shifting income to family members — in an effort to reduce their tax bills.

By failing to start planning early and look at the big picture, however, these taxpayers often miss opportunities to increase their overall wealth. A better approach is a holistic one that begins in January, considers the overall impact of various tax, business and financial planning decisions, and identifies the strategies that are most likely to enhance your net worth.

A wider focus

Focusing on tax planning alone may cause you to make poor business or investment decisions. Buying equipment, for example, can generate significant tax deductions. But if you don't really need the equipment or if the money would be better spent elsewhere, your business may end up worse off financially.

On the financial planning side, investing in municipal bonds or other tax-advantaged securities may be a good tax move. However, in many cases, taxable investments provide greater after-tax returns and, therefore, create more wealth.

A holistic approach to your 2009 tax return

Often the same income and expense items may be treated differently for tax purposes — and entered in different parts of your tax return — depending on your overall business and financial activities.

Let's look at unreimbursed employee expenses, such as professional dues, continuing professional education, subscriptions and certain travel expenses. Many people automatically deduct these expenses on Schedule A, where they're subject to the 2% floor for miscellaneous itemized deductions.

But what if in addition to your regular job you also do some consulting or own a business? If the expenses also benefit these other ventures, a greater portion may be deductible on Schedule C or some other part of your return.

To maximize your deductions and other tax benefits, each item should be considered in light of your overall circumstances and entered in the place where it will have the best impact. A professional tax advisor can be invaluable in determining the most appropriate place to deduct each expense.

It's equally dangerous to focus on business or investment planning without considering the tax implications. Acquiring another company may be a smart business move, for instance, but there may be several ways to structure the transaction, each with different tax consequences. To achieve the best result, you have to consider the business advantages and the tax benefits of each strategy.

Buying equipment can generate significant tax deductions. But if you don't really need the equipment or if the money would be better spent elsewhere, your business may end up worse off financially.

The importance of integration

It's also important to integrate business and personal tax planning. Suppose, for example, that your closely held business is structured as a C corporation. One tax-planning rule of thumb says that to avoid double taxation you should, to the extent possible, distribute corporate profits in the form of deductible expenses, such as salaries. This would reduce corporate-level taxes. But to determine the best strategy, you also need to consider personal income taxes.

Salary you receive from the corporation is taxed at individual tax rates as high as 35% and is subject to employment tax, while qualified dividends are currently taxed at only 15%. Additionally, the first $50,000 in corporate income is also taxed at a 15% rate.

When you look at your personal and corporate tax situation as a whole, you might find that you'd be better off distributing $50,000 of corporate income as a dividend rather than salary. The combined corporate and dividend tax rates could result in lower overall taxes than what you'd pay on $50,000 in salary.

Year round diligence

By definition, a holistic approach to tax planning requires that you incorporate tax considerations into all of your business and financial decisions throughout the year, rather than waiting until year end. Although it may be difficult to find the time to focus on this task, the payoff — better-informed decisions and higher net worth — makes it worth the effort.

tax TIPS

Watch out for shareholder loans

It's not unusual for S corporation shareholders to lend the company money for working capital or other needs. But without careful planning or proper documentation, these loans can produce some unpleasant tax surprises.

For example, a shareholder's basis is increased by the face amount of the loan made to the company. But if the loan basis is reduced (by business losses, for example) and the company repays the entire loan, generally any excess of the loan repayment amount over the shareholder's basis in the loan could be taxable.

To avoid unnecessary taxes, S corporation shareholders should consult their tax advisor before making loans to the company and before the company repays any such loans. ◎

Can you deduct job search expenses?

If you or someone in your family is looking for a new job, check with your tax advisor to see if the job search expenses are deductible and, if so, document them. Qualified expenses — including employment agency fees, resumé preparation and mailing costs, and certain travel and transportation expenses — are deductible even if you don't get a new job.

But job search expenses aren't deductible if:

- You're looking for a job in a new occupation,
- There's a substantial break between the end of your last job and the time you start looking for a new one, or
- You're looking for a job for the first time.

Also, job search expenses are considered "miscellaneous itemized deductions," so they're deductible only if you itemize and only to the extent that all of your miscellaneous itemized deductions combined exceed 2% of your adjusted gross income. ◎

Year of the Roth

If you have substantial balances in a traditional IRA, now's the time to start considering a conversion to a Roth IRA, which offers tax-free withdrawals and isn't subject to minimum distribution requirements. Previously, conversion wasn't an option for taxpayers whose modified adjusted gross income was more than $100,000, but that restriction has been eliminated starting in 2010.

Keep in mind that you'll have to pay income taxes on the converted amount. Converting sooner, while many asset values may still be depressed, may minimize the tax cost. Additionally, for 2010 conversions, the taxable income can be deferred in equal installments to 2011 and 2012. This might help prevent the converted amount from pushing you into a higher tax bracket. On the other hand, it could cost you more in taxes if tax rates go up. ◎

This publication is distributed with the understanding that the author, publisher and distributor are not rendering legal, accounting or other professional advice or opinions on specific facts or matters, and, accordingly, assume no liability whatsoever in connection with its use. ©2009 TXIjf10

Fact Sheet on Auction and Consignment Income

Many people don't realize that the income they earn from auctions and consignment sales may be taxable. The IRS has released a fact sheet designed to help taxpayers understand what income they are required to report and what deductions they may be entitled to take.

If you sell widgets online or on consignment and make a profit, taxable income must be reported. Business income resulting from an auction or consignment sale is subject to the same taxes as any other business, including income, self-employment, employment, or excise taxes.

Generally, a non-business taxpayer is required to report the gain from an auction or consignment sale equal to the excess of the sales proceeds over the original cost of the item sold. It is not necessary to report the proceeds from an occasional garage or yard sale. However, if you purchase items for resale and have recurring sales, this activity will probably generate business income.

Some people sell online as a hobby. Regardless of whether or not the intention is to make a profit or a living, the resulting income must be reported. Expenses related to the hobby income can be deducted, but only if deductions are itemized on Form 1040, Schedule A.

Traditional or online auction and consignment sellers with a profit motive can generally deduct expenses that are both ordinary and necessary, defined as follows:

- an ordinary expense is one that is common and accepted in a trade or business; and
- a necessary expense is one that is helpful and appropriate for a trade or business.

Verifiable auction and consignment fees and commissions are examples of allowable business expenses. Expenses related to personal, living or family matters are generally not deductible. However, when expenses are partly personal and partly business-related, the business portion of the expense is deductible.

You may be able to deduct expenses for the business use of the home if the "regular use" and "exclusive use" requirements are met. Auction and consignment sellers may allocate their split expenses according to the percentage of space in their home that is used on a regular basis to store inventory and/or product samples (the "exclusive use" requirement does not apply). However, the residence must be the sole fixed location of the auction or consignment business. Allocable expenses may include mortgage interest, insurance, utilities, repairs and depreciation.

If you have sold, or anticipate selling, any goods in an auction or consignment activity, we would be happy to help you determine the proper tax treatment and recordkeeping requirements. Please call our office at your earliest convenience to arrange an appointment.

Farming: Farm Business Expenses

Farmers, as in any other type of business, may deduct ordinary and necessary business expenses. However, farming is a capital-intensive industry with a low ratio of income to investment. It is subject to risks such as weather conditions and widely fluctuating prices for its products that other businesses do not encounter. In addition, many types of farm income and expenses are unique to farming and are not incurred by other businesses. Therefore, there are a number of tax provisions and considerations that apply only to the business of farming.

For instance, qualified farmers can use the cash method of accounting for tax purposes. Deductions for a cash-basis taxpayer are generally allowed in the year paid. Exceptions to the general criteria for deducting expenses of cash basis taxpayers include the accounting for prepaid farm supplies, and the required capitalization of certain pre-productive costs. In addition, there are special rules for the treatment of soil and water conservation expenditures; depreciation; terracing and leveling land; feed and other costs of raising livestock; labor; fertilizer, lime and other materials for soil improvement; and vehicles.

Given the variety of special tax considerations unique to farming, it is important to review your various expenditures and their substantiation and recordkeeping requirements. Please give our office a call to arrange an appointment to discuss taking full advantage of farm tax provisions and making the proper elections.

Dunbar, Breitweiser
& COMPANY, LLP
CERTIFIED PUBLIC ACCOUNTANTS
202 North Center Street
Bloomington, Illinois 61701-3995

PRSRT STD
U.S. POSTAGE
PAID
PERMIT NO. 164
BLOOMINGTON, IL