

TAXOLUTIONS



►► *ideas on taxes*

SMALL BUSINESS JOBS ACT OFFERS TAX BREAKS AND INCENTIVES

Signed into law by President Barack Obama on September 27, the Small Business Jobs Act of 2010 extends a number of existing tax breaks for small businesses and introduces new provisions designed to stimulate business investment and ease tax burdens on business owners. In addition, the law includes a package of government-backed loans designed to help small businesses gain access to credit.

Among the new tax provisions of the law are the following:

Enhanced deduction for start-ups. For 2010, the deduction for qualified business start-up expenses jumps from \$5,000 to \$10,000. The deduction that can be claimed is reduced by the amount of the business owner's total start-up costs that exceeds \$60,000, up from \$50,000 in 2009.

Self-employment tax deduction for health care costs. In 2010 only, self-employed business owners are allowed to deduct health insurance expenses for themselves and their families when calculating their self-employment tax.

Five-year carryback of general business credits. Starting in 2010, small businesses with annual gross receipts of under \$50 million are permitted to carry back general business credits to offset

tax liabilities for five years, instead of one year. Businesses may also use these credits to offset alternative minimum tax (AMT) liabilities.

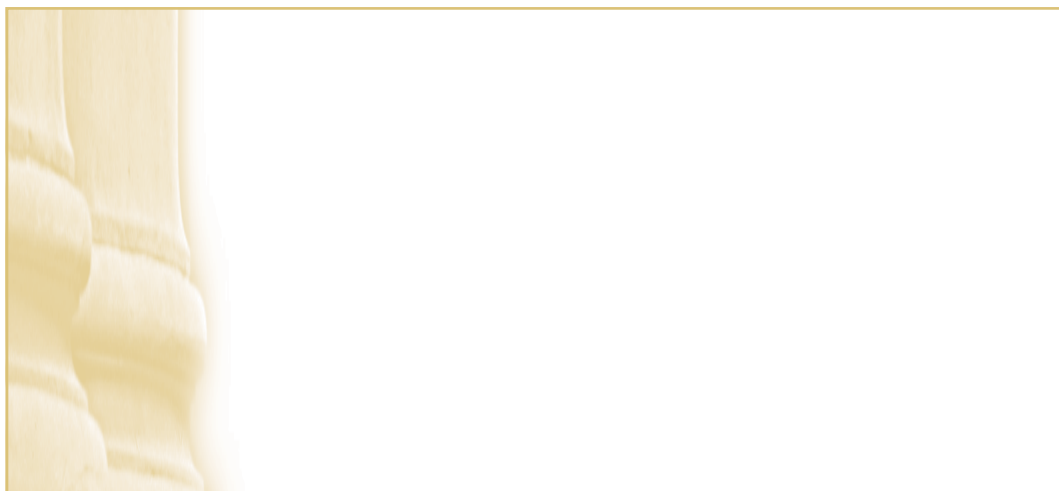
Cell phone deductions. Starting in 2010, cell phones are removed from the category of "listed property," thus enabling business owners to deduct the cost of communication devices used primarily for business purposes without having to keep extensive records.

Limits on tax shelter disclosure penalties. Under Code Sec. 6707A, taxpayers who fail to disclose participation in certain tax shelters to the IRS are liable to pay penalties. To reduce the impact on small businesses, the maximum amount of these penalties is limited to

75% of the tax benefit received, and caps have been placed on penalties for failure to disclose transactions.

Retirement account changes. Beginning in 2010, participants in 401(k), 403(b), and 457(b) plans are permitted to roll over funds into Roth accounts within their plans. For rollovers in 2010, taxable income may be spread ratably over the 2011 and 2012 tax years. Starting in 2011, taxpayers with a nonqualified annuity are permitted to annuitize a portion of the contract, while the balance continues to grow on a tax-deferred basis, provided that the annuitization period is for 10 years or more, or for the lives of one or more individuals.

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REPORTING OVERSEAS FINANCIAL ACCOUNTS TO THE IRS

As a result of an increasingly globalized world, a growing number of Americans are maintaining financial accounts with banks in foreign countries. While acknowledging that there are many legitimate reasons for owning financial accounts overseas, the IRS and the U.S. Treasury Department have recently increased their efforts to track down U.S. residents who hold accounts abroad with a total value of at least \$10,000, but who have failed to report these accounts to tax officials in the United States.

According to the IRS, it is essential that U.S. citizens and residents report these accounts, even if the accounts do not generate any taxable income, because foreign financial institutions that do not conduct business in the United States may not be subject to the same reporting requirements as domestic financial institutions, such as the requirement to file a Form 1099 to report interest paid to an account holder.

By requiring American individuals and businesses to report these accounts, IRS officials hope to be able to more effectively identify individuals who may be using foreign financial accounts to circumvent U.S. law. "Such individuals may be participating in economic crimes such as income tax evasion or embezzlement, or they may be trying to fund other illegal activity like drug trafficking or even terrorist activities," agency officials said in a recent statement.

Under the Bank Secrecy Act of 1970, a U.S. "person" who owns a foreign bank account, brokerage account, mutual fund, unit trust, or other financial account is required to file a Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts (FBAR)*, if the taxpayer has a financial interest in, signature authority over, or other authority over one or more of these accounts, and if the total value of all the foreign financial accounts exceeds \$10,000 at any time during the calendar year.

The IRS defines a U.S. "person" as a citizen or permanent resident of the

United States or any domestic legal entity, such as a partnership, corporation, estate, or trust. The IRS considers "foreign countries" to include all geographical areas outside the United States and its possessions, although accounts in U.S. military banking facilities overseas are excluded. A person with signature or other authority over, but no financial interest in, a foreign financial account may be exempted from filing an FBAR if he or she is an officer or employee of a Federally regulated bank or a Federally regulated publicly traded corporation.



Because the FBAR was created by the Bank Secrecy Act, it is not an income tax return and does not need to be filed with an income tax return. Instead, it must be mailed separately on or before June 30 of the following year to the Treasury Department. Requests for an extension of time to file an FBAR are not granted. U.S. residents must also notify the IRS that they hold overseas accounts by checking the appropriate box on Schedule B of Form 1040. Records of accounts that must be reported on an FBAR should be retained for a period of five years.

IRS officials have cautioned that there are serious consequences for foreign account holders who fail to comply with FBAR filing requirements, including civil penalties, criminal penalties, or both. For an FBAR violation occurring

after Oct. 22, 2004, the maximum civil penalty for a willful violation of the FBAR reporting and recordkeeping requirements is the greater of \$100,000 or 50% of the balance in the account at the time of the violation. Inadvertent violations can result in a penalty as high as \$10,000 a year for each violation going back several years. Criminal violations of the FBAR rules can result in a fine and up to five years in prison.

In the spring of 2009, the IRS announced a special Voluntary Disclosure Practice (VDP) for people who had not been paying their taxes on overseas accounts and temporarily extended the filing date for 2009 only. Under the special VDP, individuals were assessed either an accuracy penalty of 20% of the amount of the tax due on the under-reported income or a delinquency penalty of 25% for the previous six years. According to the IRS, approximately 14,700 individuals came forward to disclose overseas accounts under this program. While this use of special voluntary disclosures expired on Oct. 15, 2009, the IRS continues to encourage noncompliant taxpayers to use the VDP to resolve their tax liabilities, as voluntary disclosure minimizes their chances of criminal prosecution.

In an effort to track down potential tax evaders who have not come forward voluntarily, Federal officials are starting to approach foreign institutions directly. Last year, the U.S. Department of Justice settled a court case against Swiss bank UBS that required the bank to hand over account data on its U.S. customers. Under the Foreign Account Tax Compliance Act of 2009, foreign banks that hold U.S. securities or conduct transactions in dollars will be obliged to perform due diligence on their U.S. account holders starting in January 2013.

For more information about reporting requirements for financial accounts with banks in foreign countries, visit the IRS website at www.irs.gov or contact one of our qualified tax professionals. ■

TAKING ADVANTAGE OF ENERGY TAX INCENTIVES

Recent fluctuations in energy prices and increasing awareness about the effects of burning fossil fuels on the environment may have prompted you to consider purchasing energy-efficient products or installing renewable energy systems, such as solar panels or geothermal heat pumps, in your home or business. While some Federal tax incentives for green improvements are due to expire at the end of 2010, there are still a number of deductions and credits that will be in force through 2013 and 2016. When combined with incentives from state and local governments, as well as rebates from utilities, these tax breaks can substantially reduce the costs associated with “going green.”

Incentives for Homeowners

If you have made certain energy efficiency improvements to your existing primary residence over the past two years, you can claim tax credits worth up to 30% of your investment, up to a total credit of \$1,500, provided these products or improvements were placed in service between January 1, 2009 and December 31, 2010. The home energy improvements that qualify for this credit include biomass stoves, as well as HVAC systems, roofing, water heaters, insulation, doors, windows, and skylights that meet certain energy efficiency standards.

The \$1,500 maximum limit applies to all of the efficiency measures combined over the two-year period. This means, for example, that if you spent \$5,000 on energy-efficient windows and doors in 2009 and claimed the full \$1,500 tax credit on your 2009 tax return, you would not be eligible to receive credit on improvements to your roof made in 2010.

However, this upper limit does not apply to the installation of qualifying geothermal heat pumps, solar energy systems, wind turbines, and fuel cells. Currently, homeowners can claim a 30% tax credit on the installed cost of renewable energy systems through 2016. With the exception of fuel cells, there is no cap on the dollar amount. Unlike the credits that

expire in 2010, the renewable energy credits can be used to help pay for systems installed not only in an existing primary residence, but also in a new or a second home, as long as it is not a rental property. These credits are nonrefundable and may be limited if you are subject to the alternative minimum tax (AMT). If you cannot claim the full credit in the first year, you can roll over the remaining amount for one additional tax year only.

Incentives for Businesses

If you are a business owner, you may also be able to take advantage of deductions for making energy efficient improvements and credits for installing renewable energy systems in commercial buildings. Existing tax deductions for installing qualifying energy-efficient property in a new or renovated commer-

able to claim a partial deduction of up to \$0.60 per square foot for efficiency improvements that meet other specified targets. To qualify for this deduction, the energy improvements must be measured and certified by qualified and licensed engineers or contractors using software from the U.S. Department of Energy. The deduction is available for buildings placed in service between January 1, 2006 and December 31, 2013.

In addition to these deductions, a number of tax credits have been extended and enhanced for businesses that install onsite renewable energy systems, including solar, wind, and geothermal systems, as well as fuel cells and microturbines. These credits are worth up to 30% of the installed cost of solar, small wind, and fuel cell systems, with no dollar caps, and 10% of the installed costs



cial or apartment building have been extended through 2013. Only buildings covered by the ASHRAE 90.1-2001 standard are eligible.

Businesses are permitted to claim a deduction of up to \$1.80 per square foot if the improvements are whole-building energy efficiency projects that lower the total amount of energy use by at least 50% compared to a similar building that satisfies the ASHRAE 90.1-2001 standard. In terms of whole-building energy use, the three areas measured are the lighting systems; the building envelope; and the heating, cooling, and water heating systems. Businesses may also be

of geothermal, microturbines, and combined heat and power (CHP) systems, with no upper limit for geothermal systems, but a cap based on generating capacity for microturbines and CHP systems. The credits apply to solar and wind power systems placed in service between January 1, 2006 and December 31, 2016, and to geothermal and CHP systems installed between October 3, 2008 and December 31, 2016.

Because these tax breaks are temporary, it is important to plan ahead when considering energy efficiency improvements. For more information, consult one of our qualified tax professionals. ■

IRS Clarifies the Deduction for Luxury Home Loan Interest

With a new revenue ruling, the IRS has clarified the limit for the deduction of interest on a luxury home mortgage. Rev. Rul. 2010-25 addresses the issue of whether indebtedness that is incurred by a taxpayer to acquire, construct, or substantially improve a qualified residence can constitute "home equity indebtedness," rather than "acquisition indebtedness," to the extent it exceeds \$1 million.

Generally, with respect to the home mortgage interest deduction, the amount of indebtedness treated as acquisition indebtedness is limited to \$1 million, or \$500,000 for a married individual filing separately, and any indebtedness in excess of \$1 million is not considered acquisition indebtedness under section 163(h)(3). In addition, home equity indebtedness is generally limited to \$100,000, or \$50,000 for a married individual filing separately.

In Rev. Rul. 2010-25, the IRS outlined a case in which an unmarried individual taxpayer purchased a principal residence for its fair market value of \$1.5 million in 2009. He made a down payment of \$300,000 on the home and financed the remainder by taking out an 80% loan of \$1.2 million that was secured by the residence. The taxpayer paid interest that accrued on the indebtedness during that year and had no other debt secured by the residence.

In the ruling, the IRS stated that this taxpayer may deduct, as interest on acquisition indebtedness, the amount of interest paid in 2009 on the \$1 million of the \$1.2 million indebtedness used to acquire the principal residence. However, the IRS also clarified that the taxpayer may deduct, as interest under the home equity indebtedness limitation, the amount of interest paid in 2009 on

\$100,000 of the remaining indebtedness of \$200,000. According to the ruling, the \$200,000 is secured by the qualified residence, is not acquisition indebtedness under section 163(h)(3)(B), and does not exceed the fair market value of the residence reduced by the acquisition indebtedness secured by the residence. Thus, \$100,000 of the \$200,000 is treated as home equity indebtedness under section 163(h)(3)(C).

Therefore, the IRS declared, the taxpayer may deduct for 2009 interest paid on indebtedness of \$1.1 million as qualified residence interest, though any interest on the remaining indebtedness of \$100,000 is nondeductible personal interest under section 163(h).

For more information regarding the ceiling for tax deductions on luxury homes, contact one of our qualified tax professionals. ■

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The legislation also extends and broadens a number of the small business provisions included in previous stimulus packages:

Extension of bonus depreciation. For qualifying property bought and placed in service in 2010, small businesses have the option of depreciating 50% of the adjusted basis of the property. This is an extension of the 50% bonus depreciation provision of the American Recovery and Reinvestment Act (ARRA). Under the new legislation, bonus depreciation is also decoupled from the allocation of contract costs for certain assets.

Enhancement of Section 179 expensing. For 2010, and 2011, small businesses may expense up to \$500,000 of Section 179 property, up from \$250,000 in 2009. The amount is reduced only if the cost of the Section 179 property exceeds \$2 million, up from \$800,000 in 2009. The definition of qualified Section 179 property is temporarily expanded to include certain types of

real property, but the expensing amount is limited to \$250,000 for this property.

100% exclusion on sales of small business stock. Under ARRA, investors were permitted to exclude 75% of the gain from the sale of certain small business stock acquired and held for more than five years, up from 50% previously. Under the new law, the exclusion of qualified stock purchased between the date of enactment and January 1, 2011 is raised to 100%, and the excluded gain is not subject to the AMT.

Five-year S Corporation built-in gain period. For a C corporation that has been converted to an S corporation, the holding period for appreciated assets to avoid the highest corporate-level tax rate has been further shortened to five years for assets sold beginning in 2011, down from seven years in 2009 and 2010.

Among the provisions to help raise revenue, the new law expands reporting requirements for rental income from

certain real property starting in 2011, increases failure-to-file penalties for returns filed on or after January 1, 2011, and raises the amount of corporate estimated tax payments in 2015.

In addition, the Small Business Jobs Act offers increased lending to qualified small businesses. Provisions include an increase in the limits on Small Business Administration (SBA) 7(a) loans (from \$2 million to \$5 million), 504 loans (from \$1.5 million to \$5.5 million), and microloans (from \$35,000 to \$50,000), as well as the elimination of borrower fees on 7(a) and 504 loans through the end of 2010. The law also increases government guarantees on 7(a) loans from 75% to 90% and provides assistance to states to support small business lending programs.

For more information, consult one of our qualified tax professionals. ■