

# tax report

NOVEMBER 2010

## Late-year Tax Moves

Taxpayers may be facing a considerably different income-tax environment in 2011. So taking some time before year-end to look at possible last-minute steps you could take to reduce your 2010 federal income taxes could be beneficial. Here are some moves to consider.

**Pay out company dividends.** Unless Congress passes new legislation, the top four income-tax brackets will revert from their current 25%, 28%, 33%, and 35% levels to their pre-2001 levels of 28%, 31%, 36%, and 39.6%. The 10% bracket will go away. So, the lowest bracket will be 15%. Also, the maximum rate on qualified dividends will increase from 15% to 39.6%. Consequently, if your C corporation has substantial earnings and profits, you should consider distributing at least a portion of them to you and your fellow shareholders before year-end.

### **Convert to a Roth IRA.**

For 2010 only, taxpayers have the opportunity to defer income realized from converting a traditional IRA to a Roth IRA. They can spread that income ratably over the 2011 and 2012 tax years. You don't have to use this special rule, though. If you expect to be in a higher marginal tax bracket in 2011 and 2012, you might want to elect to have all of the income generated by a Roth conversion included in your 2010 income and pay the resulting taxes.

**Recharacterize a Roth conversion.** What if a Roth conversion you made earlier in 2010

wasn't a tax-wise decision? For example, maybe the IRA's value has dropped since the conversion, and you'll have to pay tax on value that you no longer have. (The amount of income you have to report on a Roth conversion depends on the taxable value of the IRA at the time of conversion.) You can undo the Roth conversion by *recharacterizing* the transaction, thus changing the account back to a traditional IRA. Other requirements apply.



**Use FSA money to stock up on over-the-counter medicines or drugs.** After 2010, FSA money can no longer be used to buy over-the-counter medicines or drugs (such as antacids, allergy medicines, pain relievers, and cold medicines) unless a doctor prescribes them. If you've been using your FSA for these items, you may want to stock up before year-end.

**Tap into your Coverdell education savings account for primary or secondary school expenses.** As the tax law currently stands, 2010 is the last year in which you can withdraw earnings from a Coverdell education savings account tax free to pay primary and secondary private-school tuition and other qualified expenses.

**Use a credit card for charitable contributions.** You can increase your deductible charitable contributions for the year by using a credit card to make a tax-deductible gift in 2010 that you can pay for in 2011. ■

## 179 Limit Increased

Section 179 of the federal tax code allows businesses to write off purchases of equipment and other qualifying assets in the year the assets are placed in service instead of claiming depreciation deductions over several years. The Small Business Jobs Act of 2010 has raised the annual dollar limit on the 179 election to \$500,000 for the 2010 and 2011 tax years. The \$500,000 deduction limit is reduced dollar for dollar as qualifying asset purchases exceed \$2,000,000.

- In 2010 and 2011, certain leasehold improvement, restaurant, and retail improvement property ("qualified real property") is eligible for expensing. Limits apply.
- The Section 179 deduction can't exceed taxable trade or business income. However, any unused deduction generally may be carried over. Restrictions apply for qualified real property.
- The Jobs Act also extends 50% bonus first-year depreciation through 2010.

We can help you evaluate the potential impact of these changes.

## short takes

### Medicare Rebate Checks

Medicare recipients who reach the prescription coverage gap this year and enter the Part D "donut hole" will receive a tax-free, one-time \$250 rebate check to help cover out-of-pocket costs for prescription drugs. All Medicare recipients who fall into the donut hole and are not already receiving Medicare Extra Help are eligible for the rebate check. The first checks were mailed in mid-June, and checks will be mailed monthly throughout 2010 as beneficiaries enter the coverage gap.

### Celebrating the Holidays

Employers who want to celebrate the holiday season with their employees can take advantage of a few federal tax code rules. Generally, a business may deduct only 50% of business meal and entertainment expenses. However, the full cost of an occasional party for employees and their guests is tax deductible. And employers can give merchandise of nominal value — hams and turkeys, for example — to employees with no negative tax consequences.

*The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.*

## Is Your College Student Still Your Dependent?

A college education isn't cheap these days, and you may be chipping in to help your child get through school. But just because your child is not financially independent, you shouldn't automatically assume he or she still qualifies as your dependent for tax purposes. The tax law has some very specific requirements. To be considered your dependent, your child must:

- Be younger than 24 as of year-end
- Be enrolled as a full-time student, as the school defines it, for some part of at least five calendar months during the year
- Live with you for more than half the year (treating temporary absences from home due to education, illness, business, vacation, military service,

and other special circumstances as time spent living with you)

- Be unmarried (or, if married, your child may not file a joint return unless it's solely to claim a tax refund and no tax liability would exist for either spouse)
- Be a U.S. citizen, resident, or national or a resident of Canada or Mexico
- Not provide more than 50% of his or her own support



Pay particular attention to the support test, especially if your child receives financial aid. Scholarship money is *excluded* from the support calculation. And, while support can come from loan proceeds, if your child is obligated to repay a student loan, the money is considered support your child provides. ■

## New Form 1099 Rules

The IRS seems to have a 1099 form for everything — one for interest payments, one for capital gains, one for dividends, one for payments of miscellaneous amounts, and the list goes on. Soon that list will be even longer. To further help the IRS determine whether income-tax returns are complete and accurate, taxpayers will have to contend with new Form 1099 reporting requirements starting in 2011 and expanding into 2012.

### Internet and Card Transactions

The Merchant Card and Third-Party Payments form (Form 1099-K) is mandated by a 2008 law and will be available in 2011. The form will be filed by firms that process credit card, debit card, and similar transactions, as well as by firms that settle online transactions (e.g., PayPal).

Retailers and other merchants who conducted 200 or more payment transactions during the year that totaled more than \$20,000 will receive a 1099-K

showing their total receipts. The IRS will receive a copy of the 1099-K.

### Business or Trade Payments

In 2012, additional reporting requirements provided for in this year's health care reform law will kick in. The requirement to report on Form 1099-MISC payments of nonemployee compensation, interest, rents, royalties, etc., made in the course of a business or trade will be expanded to include payments made to corporations (other than tax-exempt corporations).

Also, trade and business taxpayers will be required to issue 1099 forms to all vendors from whom they purchased \$600 or more of goods and services.\* These new requirements will create a substantial amount of paperwork and are certain to burden businesses, especially small ones, with additional recordkeeping. ■

\* At press time, several bills have been introduced that would repeal this provision.

# Employer Penalties Under the Health Care Reform Law

As a small business owner, you may have more questions than answers concerning the recently enacted health care reform law and how it may apply to your business. One of your questions may be: Under what circumstances will an employer be subject to penalty with respect to the health care coverage it provides or fails to provide? Although the relevant penalty provisions do not take effect until 2014, now is a good time to become familiar with what's in store for businesses.

## Pay or Play

The health care reform law generally requires employers that have at least 50 full-time (or full-time equivalent) employees to offer "affordable" health insurance meeting certain minimum standards or pay one of two potential penalties. Defined seasonal workers do not count toward the 50-worker limit.

An employer may be subject to a penalty in circumstances beyond simply not providing employees with coverage. If the health care coverage provided is considered *unaffordable* (generally defined as costing the employee more than 9.5% of household income), a penalty would also apply. Similarly, if the actuarial value of the plan's share of benefits offered to employees is considered to be less than 60%, a penalty would apply.

## The Two Penalties in More Detail

Under the new law, employers that fail to provide adequate health coverage will be subject to penalty if at least one employee receives help (i.e., a "premium tax credit" or "cost-sharing reduction") to pay for his or her individual insurance purchased through a state exchange. The penalty assessment will be equal to \$2,000 per full-time employee per year, calculated on a monthly basis. There is one bright spot, however, as the law excludes the first 30 employees from the penalty calculation.

For example, if your company fails to provide adequate coverage throughout the year to your 55 employees, the amount payable as the assessed penalty

would equal \$50,000 (25 employees multiplied by \$2,000) on an annual basis, or \$4,166.67 monthly.

The second penalty will be imposed on employers that provide their employees with adequate health insurance, but that coverage is either considered unaffordable or it has a less-than-acceptable actuarial value. In these cases, if at least one employee receives help (i.e., a premium tax credit or cost-sharing reduction) to pay for health care coverage purchased through a state exchange, the employer will be liable for a penalty equal to the *lesser* of (1) \$3,000 per employee receiving help or (2) \$2,000 multiplied by the total number of full-time employees.

Generally, employers with fewer than 50 employees are exempt from the above penalties under the health care reform law. Larger "grandfathered" plans may be subject to a penalty if the coverage is considered insufficient.

## Free Choice Vouchers

Employers that offer health care coverage will be required to offer vouchers to certain employees in the amount of the employer's contribution toward the health coverage. Those employees will be able to use the vouchers to purchase insurance on a state exchange if they don't enroll in the employer's health plan. An employer won't be subject to the penalties described above for employees who received vouchers.

Some employers may find that not offering insurance and paying the penalty costs less than paying premiums for employer-provided coverage. ■

## Calendar of Filing Dates



### NOVEMBER

**1 Employers:** File Form 941, Employer's Quarterly Federal Tax Return, for the third quarter of 2010.

**10 Employers:** Deferred due date for Form 941, if timely deposits were made.

### DECEMBER

**15 Corporations:** Pay fourth installment of 2010 estimated tax.

### JANUARY

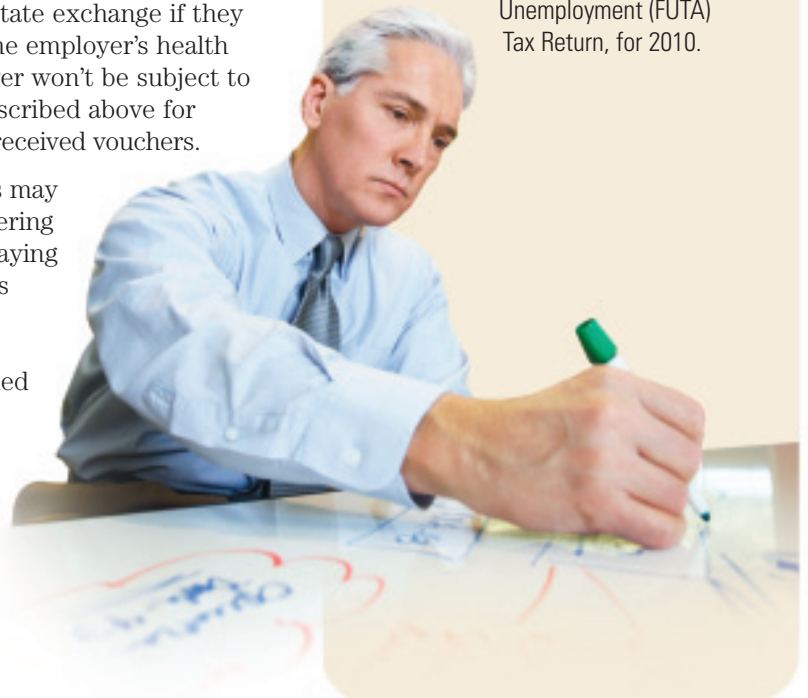
**18 Individuals:** Pay last installment of 2010 estimated tax with Form 1040-ES. Or file 2010 income-tax return and make full payment of any balance due by January 31, 2011.

**31 Employers:** Distribute copies of Form W-2 for 2010 to employees.

**31 Businesses:** Distribute Forms 1099 (or other information statements) to recipients of certain payments made in 2010. See us for more details.

**31 Employers:** File Form 941, Employer's Quarterly Federal Tax Return; quarterly deposit due.

**31 Employers:** File Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, for 2010.



## 401(k) Fiduciary Checkup

If your company has a 401(k) retirement plan, you are probably aware of the fiduciary responsibilities that accompany plan sponsorship. Continuing economic uncertainty and market volatility make it all the more important for employers to be proactive in managing their fiduciary risk exposure. Two issues warrant particular attention.

### Fees

Ensuring that plan expenses are reasonable is a key fiduciary responsibility. The U.S. Department of Labor (DOL) recently issued interim final regulations mandating comprehensive fee disclosure by plan service providers (e.g., recordkeepers, brokers, and investment advisors), effective as of July 16, 2011. The enhanced disclosure of fee information is intended to help fiduciaries assess the reasonableness of plan fees.

### Investments

Having an up-to-date investment policy statement is critical, even if your 401(k) plan allows participants to direct their own investments. As the year winds down, you'll want to confirm that the investment choices your plan offers are still appropriate. If your plan offers target date funds, make sure you examine each fund's "glide path" (the schedule by which a target date fund's asset allocation is adjusted) to ensure it is reasonable and appropriate. Earlier this year, the DOL and the Securities and Exchange Commission (SEC) issued an investor bulletin that discusses target date funds ([www.dol.gov/ebsa/pdf/TDFinvestorbulletin.pdf](http://www.dol.gov/ebsa/pdf/TDFinvestorbulletin.pdf)). ■

## Selling Stock? Knowing Your Basis Is Critical

You sell shares of stock and receive a confirmation of the transaction from your broker. It shows the information pertinent to the sale, including the sales price and the brokerage commission.

So far, so good. But you'll need more information when you're figuring your capital gain or loss for tax purposes: You'll also have to know your "adjusted basis" in the shares you sold. The basis calculation is different depending on the way you acquired your shares.

### If You Purchased the Shares . . .

Your basis is generally equal to your cost. Assuming you sell all your shares of a particular stock, your basis will be the total cost of all your share purchases, including the cost of any shares purchased through a dividend reinvestment program.

What happens if the sold shares represented only a portion of your holdings in that stock? If you purchased all your shares in a single transaction, you figure your basis by applying the per-share purchase price to the number of shares sold. If you bought your shares at different times and prices, you assign a cost

to the sold shares using one of two methods:

- Specific identification — at the time of the transaction, you instruct your broker to sell certain shares with reference to their acquisition date and cost
- First-in, first-out (FIFO) — you assume that the shares you purchased first are the first shares sold, and work forward from there



### If You Received the Shares as a Gift . . .

In general, your basis is the same as the donor's basis. But, if you are figuring a capital loss on your stock sale, you substitute the shares' market value on the gift date for the donor's basis if that market value is less.

### If You Inherited the Shares . . .

Usually, their market value at the time of death becomes your adjusted basis. But exercise caution if you inherit stock this year because, in the absence of new federal estate-tax legislation, the basis "step-up" rules are somewhat different for 2010. (No estate-tax legislation has been enacted at press time.) ■