THE MYERS ASSOCIATES, P.C.
Certified Public Accountants

520 Pike Street, Suite 1040
Seattle, Washington 98101-2397

(206) 623-6116
Fax (206) 623-6929
http://www.tma-cpas.com

February 2011

# TMA REPORT

## What's Included?

- Effects of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010
- Cost Basis Reporting Begins for Securities Purchased after 2010
- Mandatory E-Filing
- Not for Profit Corner
- New Health Insurance Credit for Small Businesses
- Registered Domestic Partners and National Tax Treatment
- Washington Penalty and Interest Amnesty
- TMA Goings-On

## EFFECTS OF THE TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOB CREATION ACT OF 2010

### Payroll Tax

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 reduces the employee's portion of the social security tax from 6.2% to 4.2%. The tax savings will vary for each person, but if you make above the Social Security wage base of $106,800, your tax savings will be $2,136. This reduction is only for 2011.

Because the reduction only applies to the employee's share of social security, there is no special benefit to employers. This reduction also has no impact on employee eligibility for social security since eligibility is based on lifetime earnings, rather than contributions. The reduction also decreases the self-employment tax from 15.3% to 13.3%. If you have any household employees (e.g., a nanny), this reduction affects their pay as well.

### Nontaxable IRA Transfers to Eligible Charities

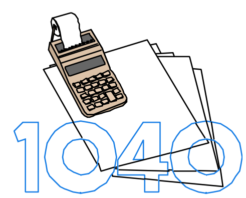
Taxpayers over age 70½ may again make tax-free distributions to a charity from an IRA of up to $100,000. This contribution counts toward the minimum distribution requirement. Distributions made in January of 2011 may be treated as made in December of 2010 and applied to 2010 taxes, but only this one time.

### Expansion of First-Year Depreciation

Qualified property placed in service after September 8, 2010 and before January 1, 2012 may be fully depreciated in the first year. These items must be purchased new. Property placed in service in 2012 may be depreciated using the bonus depreciation rate of 50%.

In addition, the first-year depreciation cap for autos and trucks has been increased by $8,000 for 2011, so that autos have a cap of $11,060 and light trucks or vans have a cap of $11,160.

### Items Renewed from 2009




- Tax rates will be 10%, 15%, 25%, 28%, 33%, and 35% until 2012. These are in contrast with the rates that would have taken effect beginning in 2011: 15%, 28%, 31%, 36%, and 39.6%. These higher rates are still scheduled to take effect beginning in 2013.
- No reduction in personal exemptions based on adjusted gross income.
- Treatment of capital gains and dividend income – Maximum rate is 15%. 0% if adjusted capital gain would otherwise be taxed below 25% if it were ordinary income.
- Expanded Child Tax Credit – Maximum $1,000 for each dependent child under 17, modified by adjusted gross income; can offset the alternative minimum tax.
- American Opportunity Tax Credit – 100% of first $2,000, and 25% of second $2,000 used for qualified post-secondary educational expenses.
- Exclusion of 100% of gain on certain small business stock – if acquired between September 28, 2010 and December 31, 2010; 75% if acquired between February 18, 2009 and September 27, 2010.
- Nonbusiness Energy Property Credit – Extended through December 31, 2011, with an aggregate credit of $500 for 2010 and 2011.

### Tax Provisions That Were NOT Extended:

- Health insurance deduction when computing self-employment tax; permitted for 2010 only.
- Real property tax deduction for non-itemizers.
- Partial exclusion for unemployment benefits received.
- Alternative Motor Vehicle Credit: Advanced Clean Burn Technology, New Qualified Hybrid Motor Vehicle Credit and New Qualified Alternative Fuel Motor Vehicle Credit.


### New Estate and Gift Tax Rules for 2010–2012

The new law includes favorable estate tax provisions for individuals who died in 2010, as well as those who die in 2011 and 2012. Here is a brief summary.

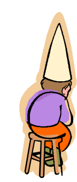
**$5 Million Estate Tax Exemption and 35% Rate.** For estates of individuals who die in 2010–2012, the Act establishes a $5 million federal estate tax exemption with the 2012 amount indexed for inflation. Taxable estates are taxed at 35% above the $5 million threshold.

**Unused Estate Tax Exemption Can Be Left to Surviving Spouse**. For the first time, married individuals who don't use up their estate tax exemptions will be able to pass along unused amounts to surviving spouses. In other words, unused exemptions of individuals who die in 2011 or 2012 (but not 2010) will be "portable." The ability to pass along unused estate tax exemptions to surviving spouses is a very favorable development. It allows both spouses' exemptions to be utilized without having to set up a credit shelter trust or engage in other tax planning maneuvers—as long as they both die in 2011 or 2012. Unfortunately, this new portability rule sunsets after 2012, so it won't help decedents who die after 2012. Also, the portability rules do not apply to the generation-skipping transfer tax exemption. Thus, trusts may still be needed in certain situations.

**Unlimited Basis Step-ups for Inherited Assets.** For heirs of decedents who die in 2011 and beyond, the familiar rule that allows the federal income tax basis of inherited capital gain assets (such as real estate and stock) to be stepped up to reflect fair market value on the date of death is reinstated. This favorable rule is also reinstated for decedents who died in 2010 and file a federal estate tax return, unless the estate elects to instead use the modified carryover basis rule. With the restoration of the unlimited basis step-up rule, heirs won't owe any federal capital gains taxes on appreciation that occurs through the date of death—as long as that date is after 2010 or, for decedents who died in 2010, their estate doesn't elect to use the modified carryover basis rules.

**Estate and Gift Tax Exemptions and Rates Are Equalized**. The Act sets the lifetime federal gift tax exemption for 2011 and 2012 at $5 million—with the 2012 amount indexed for inflation (ditto for the generation-skipping transfer tax exemption). Thus, the gift tax and estate tax exemptions are equalized for 2011 and 2012. This is a huge improvement over the previous $1 million gift tax exemption (which continues to apply for 2010). An unmarried person may now give away up to $5 million while alive without paying any gift tax, and a married couple may give away up to $10 million. (To the extent you dip into your gift tax exemption, your estate tax exemption is reduced dollar-for-dollar.) The tax rate on 2011 and 2012 gifts in excess of the $5 million exemption is 35%, same as the estate tax rate. Again, thanks to sunset provisions, the gift tax exclusion reverts to $1 million after 2012.

### Penalties in the Small Business Jobs Act of 2010



One effect of the Small Business Jobs Act of 2010 has been to increase penalties for incorrect tax information returns and payee statements, such as Form 1099s. These penalties have doubled from $50 to $100 for each return or statement.

As a reminder, businesses are required to issue a Form 1099 to every individual and partnership paid $600 or more for services during each calendar year. In addition, if you make payments to attorneys or medical practitioners of $600 or more during the year, you must issue them a Form 1099 even if they are incorporated. Therefore, it makes sense to have every vendor provide you with an IRS Form W-9 (the form that requests their ID number) BEFORE you pay them. Once vendors have received your payment, they are much less likely to be responsive to your request for their ID number.

Starting in 2011, if you are a landlord, you now have the requirement to issue Form 1099s as well. The same $600 threshold applies. (This provision is under review and may be modified.)

Our experience with the IRS has shown their consistent concern regarding the filing of 1099s and other information returns. During an audit of a business, it should be expected that the IRS auditor will ask for copies of all filed 1099s. ♦

## COST BASIS REPORTING BEGINS FOR SECURITIES PURCHASED AFTER 2010

Beginning in 2011 (equities) and extending through 2012 (mutual funds) and 2013 (fixed income/bonds), brokers will be required to report the cost basis for their clients' investment sales. This requirement only applies to investments purchased after the first of the year in which reporting is required.

The taxable gain or loss on an investment sale is the proceeds less the cost basis. The two methods of calculating the cost basis for equities are:

- FIFO – First-in-First-out is the default method used by the IRS. If the specific shares are not identified in another manner, the IRS assumes that the first shares purchased will be the first ones sold.
- Specific Identification – Alternatives to FIFO require that the cost basis of the specific shares to be sold can be identified.
- Selling the stock with the highest cost basis first, or as Last-in-First-out, are acceptable methods, as long as the specific purchase lot can be identified.
- The cost basis of stock received as a gift is the same as the cost basis of the previous owner.

For mutual funds, whose cost basis is not reported to the IRS until 2012, two additional options are available:

- Average Cost Single Category – Establish an average cost-per-share which is used for all sales and updated with purchases; may be calculated automatically by brokerage firm.
- Average Cost Double Category – Averages are calculated separately for short term and long-term positions.

It is important, therefore, to specify which stocks will be sold so that the brokerage firm is able to report the correct cost basis to the IRS. Note also that dividend reinvestments will increase the cost basis. ♦

## MANDATORY E-FILING

We have found that e-filing generally increases the speed and accuracy of filing. In 2011, by law, we are required to file all individual and trust returns electronically.

This does not mean that individuals, even those who use the services of a tax preparer, are compelled to file electronically, however. There is a provision for taxpayers to opt-out of e-filing if they wish. ♦

# NOT FOR PROFIT CORNER

### Personal and Real Estate Property Exemption for Nonprofits

For nonprofits, personal and real property used for certain activities can be exempt from Washington property taxes. This exemption is not broad or automatic, however. Annually, the nonprofit must file for an exemption from property taxes with the State of Washington Department of Revenue.

Schools, churches, cemeteries, social service organizations, character building organizations, nursing homes, museums, and public meeting places can receive the exemption. In addition, arts and cultural organizations can be exempt for the areas which are actually used for performances for the general public.

If the activities are exempt for real estate taxes, they will also be exempt for personal property taxes for King County. If they would not be exempt for state purposes, then personal property tax is also due. ♦

## NEW HEALTH INSURANCE CREDIT FOR SMALL BUSINESSES

A new tax credit is available to small businesses which provide health insurance to employees. The initial requirements are that the company employ no more than 25 full-time-equivalent employees (FTE's), have average wages less than $50,000 per FTE, and have a qualified health insurance plan that requires it to pay at least half of the premiums for everyone who enrolls in the plan. Owners of the business and family members are excluded from the calculations.

Qualified plans must be funded by insurance, and cannot therefore be self-insured plans, HRAs, HSAs or FSAs.

While the maximum credit is 35% of the employer cost of the health care premiums, there are dual phase-outs after 10 FTEs and an average wage over $25,000. Since these phase-outs stack, the credit gets reduced drastically if the business has over 10 FTEs or pays more than $25,000 per FTE.

Nonprofits can also claim this credit, with an additional restriction that it cannot exceed the actual federal withholding and Medicare taxes withheld during the year. The credit is claimed on Form 990-T, which might not need to be filed if not for the credit.♦

## REGISTERED DOMESTIC PARTNERS AND NATIONAL TAX TREATMENT

Community property states (which include Washington) are those in which each spouse reports half of the combined income and withholding from earned income as well as one half of the income from community property assets (a more complex designation that generally includes anything purchased or mixed with community income).

Domestic partners cannot file their federal return as married filing jointly or married filing separately since the federal government does not recognize domestic partnerships. However, the federal government has historically recognized the property laws placed in effect by the states.

Following a recent 9th Circuit case and IRS Chief Counsel Advice, covering the states of California, Nevada and Washington, the IRS now requires members of registered domestic partnerships to report their combined income and property according to community property law. That is, although the two taxpayers will each file as either single or head of household as appropriate, they are required to each report one half of their income and withholdings from community property income.

This means that if one partner earns $80,000 and one earns $40,000, each would pay tax based on $60,000 of taxable income, which should reduce income taxes overall. ♦

## WASHINGTON PENALTY AND INTEREST AMNESTY

The amnesty covers penalties and interest related to the Washington Business & Occupation Tax, Washington public utility tax, as well as Washington and local sales and use taxes which became due before February 1, 2011, or were required to be paid before that date. Excluded from this program is any taxpayer who has filed and paid all returns due as of November 25, 2010, as well as any taxpayer that has been assessed a penalty by the Washington Department of Revenue for evasion or misuse of a reseller permit or resale certificate, or who has been prosecuted for failing to pay tax by the Department. Also excluded are those in bankruptcy if the payment of the debt would violate federal bankruptcy laws.

In order to apply for a waiver of penalties and interest on late filings, all outstanding tax returns or amended returns covered by the waiver must be filed. In addition, all tax due must be paid by April 30, 2011, as well as all penalties and interest not covered by the waiver.

Participants in this program waive the right to seek a refund or challenge the amount of taxes paid under the program. ♦

## TMA GOINGS-ON

Niall O'Donoghue joined our staff in January 2011 after having spent the past two years teaching primary, secondary and college level English in Kazakhstan with the US Peace Corps. He graduated from Reed College in 2007 with a B.A. in Classics, and is presently preparing to sit for the CPA exam in Washington.


ALWAYS FEEL FREE TO CONTACT US!

Call or e-mail us with your ideas for future articles on topics of interest or with names of others who may want to receive *TMA Report*. Also note that previous issues of all our newsletters, which include *On The Not-For-Profit Front* and *Small Business Outlook*, are included in the newsletter section on our website: http://www.tma-cpas.com

## THE MYERS ASSOCIATES, P.C. STAFF DIRECTORY

Following is a listing of our e-mail addresses and telephone extensions. To reach us, dial (206) 623-6116, wait for the greeting and press the extension of the person you would like to reach.

| Name | E-mail | Ext |
|---|---|---|
| *General office* | tma@tma-cpas.com | 0 |
| *Mary Joyce, CPA* | Mary@tma-cpas.com | 207 |
| *Mark Long, CPA* | Mark@tma-cpas.com | 204 |
| *Bill Hood, CPA* | Bill@tma-cpas.com | 208 |
| *Julie Sandygren, CPA* | Julie@tma-cpas.com | 203 |
| *Tessa Dul, CPA* | Tessa@tma-cpas.com | 205 |
| *Michael Davis* | Michael@tma-cpas.com | 210 |
| *Marissa Betz-Zall, CPA* | Marissa@tma-cpas.com | 213 |
| *Niall O'Donoghue* | Niall@tma-cpas.com | 202 |
| *Mary Ingersoll* | MIngersoll@tma-cpas.com | 206 |

Please let us know if you have any questions, would prefer to receive this as a pdf attachment to an email or know of someone who should also receive this newsletter.