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Tax & Business letter

FALL
2011

IRS explains the new bonus depreciation rules

Under the *Tax Relief Act of 2010*, you may be able to write off the entire cost of business property placed in service this year, thanks to 100% “bonus depreciation.”

Prior to this law, a business was able to claim 50% bonus depreciation on qualified new (but not used) property placed in service in 2010. This included property with a cost recovery period of 20 years or less, most computer software, qualified leasehold improvement property, and certain water utility property. Bonus depreciation could be coordinated with Section 179 first-year expensing and regular depreciation deductions (subject to the annual limits).

The Tax Relief Act, signed December 17, 2010, improves and extends the tax benefits. It allows a business to claim 100% bonus depreciation for qualified property placed in service from September 9, 2010, through December 31, 2011 (through 2012 for property with a cost recovery period of ten years or more and certain aircraft and transportation property). 50% bonus depreciation can be claimed for qualified property placed in service during 2012.

The *Tax Relief Act of 2010* did not change the definition of “qualified property”; it remains the same as it was before.

IRS issues guidance

Recently, the IRS issued new guidance on using bonus depreciation. It focuses on the following areas:

■ Depreciation step-down

You’re allowed to “step down” from 100% bonus depreciation to 50% bonus depreciation this year if it suits your needs. For example, it may not be advantageous for a business to front-load its depreciation deductions to receive the maximum amount. The IRS guidance spells out the procedure for cutting back to 50% bonus depreciation.

■ Company vehicles

The first-year depreciation deduction for “luxury cars” and other vehicles is enhanced by \$8,000 due to the bonus depreciation rules.

Certain heavy-duty vehicles are exempt from the luxury car limits. If purchased after September 8, 2010, and before January 1, 2012, and used 100% for business, they may qualify for 100% bonus depreciation.

■ Qualified leasehold property

The IRS says that qualified restaurant and retail improvement properties may be eligible for 100% bonus depreciation under the definition of “qualified leasehold property.”



■ Component depreciation

A business may be able to deduct certain components of a business building over a faster cost recovery period than the usual 39-year period required for an entire building. The IRS ruling authorizes an election to use 100% bonus depreciation for qualified components of a self-constructed building.

Even with the recent IRS guidance, the depreciation rules remain very complicated. For assistance in applying the rules for maximum tax benefit to your business, contact our office. ♦

IRSTAX NOTES

IRS raises mileage rates

The IRS announced an increase in the standard mileage rates for deducting costs of driving for business or for medical or moving reasons. The new rates will apply to driving from July 1, 2011, through December 31, 2011. The revised rates are 55.5¢ per mile for business driving, 23.5¢ for medical and moving driving. The rate for charitable driving is fixed by law and remains at 14¢ per mile.

E-mail scam alert issued

The IRS is again warning taxpayers not to respond to the latest flood of e-mails claiming to come from the IRS. These official-looking e-mails are sent by crooks trying to steal your identity. The IRS does not send unsolicited e-mails, and taxpayers who receive any purporting to be from the IRS should not respond.

Volunteers win tax case

If you provide care for stray or feral animals in your home for an IRS-approved charity, you may be able to take a tax deduction for your out-of-pocket expenses.

A recent U.S. Tax Court judge ruled that a taxpayer who fostered feral and stray cats in her home could deduct amounts she spent for food, veterinarian bills, litter, and other expenses incurred to help the charity in its mission. To be deductible, a taxpayer must keep records of the expenses, and the charity must provide a written acknowledgment of the volunteer's expenses as a donation. ♦



Should you consider a tax-free IRA charitable rollover?

The *Tax Relief Act of 2010* extended the provision that allows taxpayers age 70½ or older to make charitable donations of up to \$100,000 directly from their regular or Roth IRAs. But the provision is set to once again expire after this year. Should you take advantage of this option in 2011?

Charitable IRA rollovers are penalty-free withdrawals that are neither included in, nor deducted from, your taxable income. Such withdrawals qualify as required minimum distributions (RMD) from your retirement account. Thus, if you do not need the IRA distribution to live on, and you wish to make a donation, a charitable IRA rollover might be a win-win strategy.

Who are the best candidates for the tax-free IRA charitable rollover?

- ▶ If you need to take your RMD, but do not need the money and do not want to pay the tax on the distribution, doing a charitable rollover would keep the RMD from inclusion in your taxable income.

- ▶ If you make large donations, and your charitable contribution deduction is limited due to the 50% or 30% of AGI limitations, this may be an opportunity for you to continue to fund your charities and not exceed the limitations.

- ▶ If you are receiving social security, it may be better to make the IRA

gift directly to charity so taxable income doesn't increase and subject your social security benefits to taxation.

- ▶ If you claim the standard deduction, a donation to charity is not deductible. But you can make the IRA gift directly to charity and avoid additional income tax on the RMD.

- ▶ If you want to reduce your taxable estate, a charitable IRA rollover can reduce your taxable estate by \$100,000 (\$200,000 for a couple).

Keep in mind that there are unique restrictions on this type of charitable gift. The IRA rollover cannot be contributed to a donor advised fund or supporting foundation. Also, if any benefit is received in exchange for the gift, such as dinner tickets, the entire distribution becomes taxable. As with any donation, the charity needs to provide you with a tax receipt containing all the proper substantiation for your contribution. Without it, the gift is disqualified. Also be aware that the donation must be made directly from the IRA to the charity and not paid to you first.

The charitable IRA rollover is a powerful new tool for tax and gift planning. But remember, the provision is set to expire this year. Give our office a call today for assistance in analyzing whether this option is a tax-smart move for you. ♦

Take a course on saving for college the tax-smart way

With tuition costs climbing ever higher, setting aside funds for college can be a formidable task. Here's a refresher course on the various programs and tax breaks you can use to lessen the financial burden of college.

■ **Coverdell education savings accounts.** These accounts offer several advantages over other college savings plans. First, there's flexibility. Like an IRA, you can choose from a wide variety of investments to meet your individual needs. Also, funds in the account can be withdrawn tax-free if used for qualified education expenses such as tuition, room and board, books, even a computer. Unlike other programs, qualified expenses include costs of elementary and secondary school.

However, the maximum annual contribution for a beneficiary is \$2,000 –

from all sources. Also, funds must be used by age 30. If the funds are not spent on college by the time the beneficiary is 30 years old, the unspent money must be withdrawn (subject to income tax and a 10% penalty) or rolled over into another family member's education savings account.

■ **Section 529 plans.** If you want to put a large lump sum into a college savings account, a Section 529 plan may be your best option. In this type of account, there are no phase-out limits for high earners, and plan sponsors set maximum allowable contributions.

■ **Custodial accounts.** With custodial accounts (Uniform Transfers to Minors Act or UTMA), you can generally invest in a wider variety of investments than with a 529 plan. The proceeds can be taken out penalty-free – even if used for something other than education. The biggest potential disadvantage is that you gift the funds irrevocably to the child. At a certain age, your child controls the account and could spend the funds on a sports car instead of college.



■ **American opportunity credit.** With this credit you reduce your taxes dollar for dollar for education expenses incurred during four years of college. The credit has an annual limit of \$2,500 per student.

■ **Lifetime learning credit.** The limit for this credit is \$2,000 per tax return, and qualified expenses include tuition, fees, and books for both undergraduate and graduate programs. You're limited to using only one credit (American opportunity or lifetime learning) per student.

■ **Other options.** Roth IRAs and U.S. savings bonds are additional options worth considering. You may also qualify for an interest deduction on education loans. If you need help reviewing the options that best fit your situation, give us a call. ♦



How grandparents can help with college costs

Are you a grandparent wanting to fund your grandchild's education? You'll find several ways to do this, each with its own limitations and tax consequences.

▶ **Gifts.** The simplest is just to make an outright gift of cash to your grandchild each year. In 2011, you can give up to \$13,000 without any gift tax liability. If your spouse also wants to join in the gift, you can jointly give each grandchild up to \$26,000 each year.

▶ **Direct payments to the institution.** There's also a way to give higher amounts and still avoid any gift tax consequences. You can give unlimited amounts if you make the payments directly to a qualified education institution on behalf of your grandchild. But there's one drawback. The payments can only be for tuition. Payments for dormitory fees, meals and accommodations,

or books don't qualify. You can still give your grandchild an additional \$13,000 for these other items though.

▶ **Education savings accounts.** If you decide against making direct tuition payments, consider making part of your \$13,000 gift as contributions to a Coverdell education savings account or a Section 529 plan. These plans and accounts generally offer tax-free growth of college savings. Age, income, and contribution limits may apply, however.

Your grandchild's total college savings could affect his or her eligibility for scholarships or other tax benefits. That's why you should coordinate your gifts as part of a comprehensive education plan. Contact our office for help setting up a tax-smart college savings plan. ♦

It's not just about the money

Studies have consistently shown that employee compensation, although important, is not the primary factor that makes workers stay at a company. It's not all about the money. In fact, some firms that provide stellar compensation packages suffer high turnover, low morale, and dwindling market share. Others – including smaller companies that may not offer tip-top benefit packages – maintain a loyal and dedicated workforce that regularly contributes to the company's success. In fact, many studies show that happy workers provide more efficient production, better customer service, and greater innovation.

What factors could make your company a better place to work? Here are four keys.

► **Respect.** Show employees that they matter by providing them with necessary training, acknowledging outstanding work,

and creating a healthy and upbeat workplace.

► **Fairness.** Treat employees equitably. This applies, of course, to hiring and promotion decisions, but might also include sharing the firm's success through a structured bonus plan.

► **A sense of pride.** Most people enjoy working with a team that accomplishes something significant. Strive to make everything you do – and everyone you employ – an integral part of the firm's mission.

► **Opportunities.** No one looks forward to a dead-end job. Give your workers an adventure to anticipate. For example, you might provide cross-training to develop new skills or encourage innovation.

Even if you can't offer the best compensation package on the planet, satisfied workers can help propel your company forward. ♦



September 15 – Due date for individuals to pay third quarter installment of 2011 estimated tax.

September 15 – Deadline for filing extended 2010 tax returns for calendar-year corporations.

September 15 – Deadline for filing extended 2010 partnership and limited liability company returns.

October 3 – Deadline for businesses to adopt a SIMPLE retirement plan for 2011.

October 17 – Filing deadline for extended 2010 individual tax returns.

October 17 – If you converted a regular IRA to a Roth IRA in 2010 and now want to switch back to a regular IRA, you have until this date to do so without penalty.

During November – Estimate your 2011 income tax liability and review your options for minimizing your 2011 taxes. Call us to schedule a tax planning review. ♦

NOTE: This newsletter is issued quarterly to provide you with an informative summary of current business, financial, and tax planning news and opportunities. Do not apply this general information to your specific situation without additional details. Be aware that the tax laws contain varying effective dates and numerous limitations and exceptions that cannot be summarized easily. For details and guidance in applying the tax rules to your individual circumstances, please contact us.

We appreciate your business. Please call any time we can be of assistance to you in your tax, financial, or business affairs.

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