Protect your personal information!

The IRS does not initiate taxpayer communications through email.

All unsolicited email claiming to be from either the IRS or any other IRS-related components such as EFTPS, should be reported to: phishing@irs.gov

Preparing for the New Cost Basis Regulations

—Laurie Hensley, CPA

New regulations now require your investment house to report cost basis on Form 1099-B. Historically, only the sales proceeds have been reported to the IRS. These new requirements will be phased in over a three year period beginning in 2011. Key points to be aware of include:

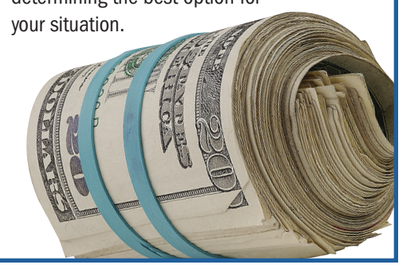
✓ Brokers will use a default method for determining gain or loss unless you notify your broker directly to opt for another method. The default methods are:

- Cost basis for stocks and bonds will be determined on a first-in, first-out basis.
- Cost basis for mutual funds will be determined using an average cost method and lots will be considered sold on a first-in, first-out basis.

✓ Specific identification is an option but detailed rules apply and specification must be made by the settlement date.

✓ Other options are available including last-in, last-out; high cost; and low cost. The options available may depend on the type of investment and your particular broker.

Please contact if you need assistance in determining the best option for your situation.



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inside

Tax Considerations of Buying or Leasing a New Automobile

—Chris Hart, Accountant

When it comes to making the decision whether to buy or lease a new automobile, the decision often revolves around how much of a down payment is required and what the monthly payment will be. When your new automobile will be used for business purposes you should also consider the tax consequences of the decision.

Personal vs. Business Financing

The first tax consideration is whether the vehicle should be acquired personally or through the business. If a taxpayer acquires the vehicle personally unreimbursed business use expenses are deductible, however, if the owner is an employee the deduction may be very limited. If a vehicle is purchased by the business the asset and related loan are recorded on the company's balance sheet and the business use is considered an ordinary business expense.

Lease vs. Buy

As opposed to leasing a vehicle, buying an automobile typically requires a higher down payment, a higher monthly payment, and a longer financing term. The benefit, of course, is that at the end of your financing term you still have the vehicle and the only additional costs are for the continued upkeep. A purchased vehicle used for business purposes can be depreciated and is eligible for bonus depreciation subject to the luxury automobile limits. The taxpayer is allowed to deduct the interest paid on the auto loan as well as deducting either the standard mileage rate provided by the IRS or the actual vehicle expenses incurred such as gas, repairs, insurance, and depreciation. The taxpayer may switch from the standard mileage deduction to the actual cost deduction but may not switch from the actual cost deduction to standard mileage. Therefore it is important to give some thought as to which deduction method to elect. Upon disposition there could be a taxable gain due to allowable depreciation.

As opposed to purchasing, leasing generally means a lower down payment, a lower monthly payment and a shorter financing period. At the end of the financing period, the taxpayer has the right to buy out the vehicle or return the vehicle back to the dealership. A leased vehicle is not depreciable for tax purposes therefore there is no gain or loss for tax purposes at the end of the lease term. Using the actual cost method, lease payments are deductible along with the other actual costs. However, the taxpayer does not have the ability to change the expensing method after the initial election. Taxpayers leasing automobiles for business purposes must also reduce deductible expenses by a standard "lease inclusion" amount which attempts to equalize lease payment deductions with deductions allowed for purchased vehicles. The major disadvantage of leased vehicles is the limited mileage allowed under the lease.

Regardless of title and financing decisions, it is important to understand that all of the deductions are limited to the business use of the vehicle. The taxpayer is required to maintain a mileage log substantiating the business use of the vehicle. The IRS is scrutinizing mileage documentation more than ever and your deductions are at risk if the proper documentation is not maintained.

Before picking out your next automobile, please give some consideration to the tax treatment of title and financing methods in order to maximize the personal, business and tax benefits of the acquisition.

Changes to Continue

From the Health Care Act

—Jennifer Piscitelli, Accountant

Since their passage in 2010, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act, collectively referred to as the Health Care Act, have had significant tax implications for individuals and businesses alike.

Some of the changes that took effect in tax years 2010 and 2011 are the introduction of the small employer health insurance credit, extension of insurance coverage for children under age 26, the restriction of over-the-counter drug purchases from health savings accounts (HSA), and an increased penalty on nonqualified distributions from HSAs.

The mandate which requires employers to report the cost of health care coverage for employees on W-2 forms was made optional for 2011. This will allow time to update payroll systems. For smaller employers filing fewer than 250 W-2 forms this requirement is optional through 2012 and may continue until further guidance is issued.

Eligible small employers should not overlook the credit allowed for certain expenditures to provide health insurance coverage for their employees. Generally, employers with 10 or fewer full-time equivalent employees (FTEs) and an average annual per-employee wage of $25,000 or less are eligible for the full credit. The credit amount begins to phase out for employers with either 11 FTEs or an average annual per-employee wage of more than $25,000. The credit is phased out completely for employers with 25 or more FTEs or an average annual per-employee wage of $50,000 or more.

This tax credit helps very small employers offset the cost of employer-provided health insurance coverage. The credit is set at 35 percent of health insurance premiums through 2013 (25 percent for tax-exempt employers), and increases to 50 percent in 2014 and 2015 (35 percent for tax-exempt). After 2013, the credit applies only to health insurance purchased through a state-established health insurance exchange.

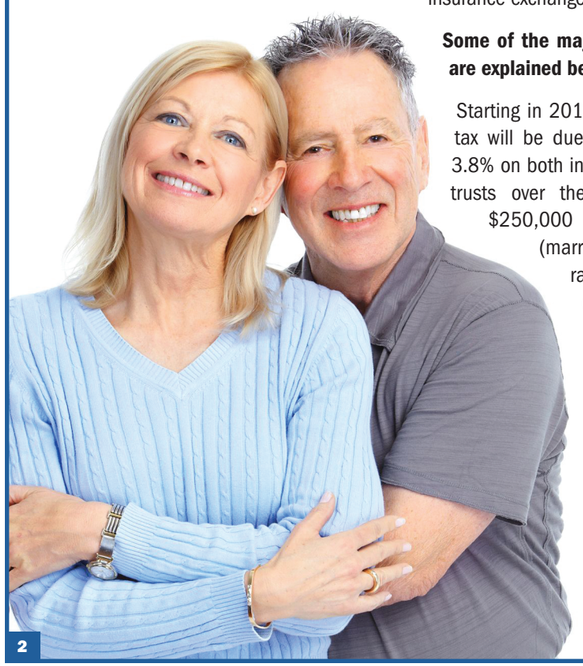
Some of the major changes yet to come are explained below.

Starting in 2013 an additional Medicare tax will be due on unearned income of 3.8% on both individuals and estates and trusts over the threshold amounts of $250,000 (joint return), $125,000 (married taxpayer filing a separate return), or $200,000 (all other cases). This was designed to pay for much of the health care reform, and is the first time a Medicare tax has applied to investment income of high earners. Tax will be assessed on the lesser of (1) unearned income or (2) the amount by which adjusted gross income exceeds the $200,000 or $250,000 threshold amounts. Unearned income is defined by the new law as interest, dividends, capital gains, annuities, royalties, and rents, but excludes tax-exempt interest and income from retirement accounts.

Also beginning in 2013 is a 0.9% Medicare surtax which will apply to wages in excess of $200,000 for single taxpayers and over $250,000 for married couples. Currently the Medicare tax is imposed equally on the employer and employee with each paying 1.45%. This change will increase the current Medicare tax from 2.9% to 3.8%, with the 0.9% being imposed solely on the employee and self-employed workers.

There will be a hike in the 7.5% floor on itemized deductions for medical expenses to 10% in 2013. Currently individuals are allowed to deduct unreimbursed medical expenses that are in excess of 7.5% of adjusted gross income (AGI) for regular tax purposes and 10% of AGI for alternative minimum tax. Taxpayers age 65 and over are exempt from the cutback through 2016.

Unless repealed, after December 31, 2013 all individuals will generally be required to maintain minimum essential health insurance coverage. Those not covered will be assessed a monthly penalty, called a "shared responsibility payment."



These are highlights of some of the changes imposed from the Health Care Act that will continue to affect the taxes of individuals and businesses in the coming years. The impact of these changes should be taken into consideration as we enter into 2012.

WHAT YOU NEED TO KNOW

—Amy Iles, CPA

Before Issuing Stock Options to Your Employees

Stock options can be a great way to hire and retain employees especially for a young start-up company with little cash, but not without careful planning and a solid understanding of the tax consequences to both you and your employees. It is important to recognize that stock option arrangements represent compensation and as such, at some point, become taxable income to the recipient. Care should be taken to minimize taxes and to inform employees that although cash may not be paid out in wages, stock option arrangements represent a form of compensation.

A stock option is a right to buy a share of stock at a fixed price (exercise price) within a specified period of time. There are two basic types of stock options received by employees, each with specific rules for income recognition. These options, often referred to as nonstatutory (nonqualified) and statutory (incentive stock options or ISO's) options, give the employee an equity share of the granting business.

A nonqualified stock option allows the employee to acquire stock at a specified price beginning on a specified date. Depending upon whether the stock option has a readily ascertainable fair market value or not, ordinary income is either recognized by the employee at the date of grant or at the date of exercise. When income is recognized at the date of exercise (the typical case with nonqualified stock options), the income taxable to the employee is the difference between the fair market value of the stock that the employee is receiving at date of exercise and the exercise price of that stock. Payroll taxes may be required to be withheld. The employer is entitled to a corresponding deduction for the amount taxable to the employee. Special recognition rules apply in cases where a nonqualified stock option is subject to substantial risk of forfeiture. These rules are complex and should be thoroughly discussed with your tax advisor before committing to a stock option arrangement.

Alternatively, statutory or incentive stock options are not taxable when granted or exercised, but rather when the stock is sold. Since special capital gain/loss treatment is available on the difference between the sales price of the stock and the price paid for the option, the employer is not entitled to a corresponding deduction. For a stock option to be treated as an incentive stock option, the option must be part of a qualified stock plan approved by the shareholders and subject to very specific requirements. In addition, the employee is prohibited from selling the stock within certain time periods of the grant date and exercise date. If these specific requirements are not met, the option is no longer considered an incentive stock option and its tax treatment becomes more similar to that of a nonqualified stock option. Incentive stock options are typically used to compensate upper management.

Although stock options can be a great way for an employer to maximize after tax profits through non cash benefits to employees, the tax laws governing these options are complicated. It is important to seek legal counsel and tax advice to minimize issues for unsuspecting employees and foster tax planning opportunities that actually boost compensation packages. Contact us as needed to help navigate through these complexities.

2011 Year-End Tax Planning

—Rita French, CPA

The Tax Code continues to become more complex largely because Congress has enacted a host of temporary tax incentives with a variety of expiration dates. Today, many taxpayers are trying to navigate all of this complexity as they draft their 2011 year-end tax plans. Uncertainty over the fate of the expiring tax provisions makes year-end 2011 tax planning a challenge for many individuals and businesses. Fortunately, we know that certain tax incentives will be available through the end of 2011 and others through the end of 2012. Additionally, some traditional year-end tax planning strategies are valuable even with all the uncertainty. This article highlights some of the more widely-utilized 2011 year-end tax strategies for individuals and businesses.

INDIVIDUALS

Income/deduction shifting. Income and deduction shifting is a traditional year-end tax strategy that is worth a look at year-end 2011. However, one key complication is uncertainty over the individual income tax rates after 2012. We know that the individual income tax rates will be 10, 15, 25, 28, 33, and 35 percent for 2012. Under current law, the 10 percent rate is scheduled to expire after December 31, 2012 and the remaining rates are scheduled to revert to 15, 28, 31, 36, and 39.6 percent after December 31, 2012 (unless extended by Congress). As a result, some taxpayers may want to abandon the traditional strategy of shifting income into a future year and recognize income in 2011 or 2012 when the lower rates are available.

Capital gains/dividends. Reduced tax rates on qualified dividends and capital gains are scheduled to expire after December 31, 2012 (unless extended by Congress). Taxpayers need to carefully review when to recognize income from qualified capital gains and dividends to maximize their tax savings in 2011 or 2012.

Charitable contributions. Seniors age 70 1/2 and older should consider making a charitable contribution directly from their IRAs up to $100,000 and paying no tax on the distribution. This tax break, especially advantageous to those who do not itemize deductions, is scheduled to end for distributions made in tax years beginning after December 31, 2011.

BUSINESSES

Bonus depreciation. Business taxpayers have a limited window in which to take advantage of 100 percent bonus depreciation (unless extended by Congress). One hundred percent bonus depreciation applies to qualified property acquired after September 8, 2010 and before January 1, 2012, and placed in service before January 1, 2012 (or before January 1, 2013 for certain longer-lived and transportation property).

Code Sec. 179 expensing. Business taxpayers also have a limited window in which to take advantage of enhanced Code Sec. 179 expensing (unless extended by Congress). For tax years beginning in 2010 and 2011, the

Code Sec. 179 dollar limit is $500,000 and the investment limit is $2 million. The dollar limit for 2012 is scheduled to fall to $125,000 (indexed for inflation at $139,000) and the investment limit is scheduled to fall to $500,000 ($560,000 indexed for inflation). Keep in mind that Code Sec. 179 expensing is also allowed for off-the-shelf computer software placed in service in tax years beginning before 2012.

Every taxpayer's situation is different. Contact our office if you wish to schedule a time to discuss your year-end tax planning in detail.