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Client Information....December, 2010/January 2011

Major tax law changes? There were significant changes in tax laws near the very end of 2010. But these changes were in large part expected so there are very few surprises for our planning processes. For the most part these changes consist of extending the "Bush" tax cuts for the next two years. While most of these changes do not actually change anything, they just extend the status quo, below are some of the most important changes which could have an effect on many of us. Because the extensions were passed so late in the year, the IRS is frantically trying to adjust their computers to properly deal with them. Accordingly, the date many tax returns can be filed will be delayed. It is expected that many returns with itemized deductions or teacher deductions will not be able to be filed before February 15.

Reduction in Social Security withholding tax. During 2011 there will be a reduction of 2% in Social Security withholding taxes. If you receive a W2 form at the end of the year, your paychecks will be slightly higher during the year. If you are self employed, you also benefit from this 2% reduction in your self employment tax.

1099 reporting for rentals. This has been kept a little too quiet, but if you own rental property you have a new reporting requirement. You must send a 1099 form to anyone who you pay more than \$600 to during the year. This could include plumbers, carpenters, handymen, lawn mowing service, management companies, and anyone else you pay money to. You must obtain an employer ID number or social security number from all these people before you pay them, usually on a form W9. This is effective for any money paid during 2011. You will have to prepare the 1099 forms prior to January 31, 2012. Penalties start at \$100 per unfiled 1099, so it is in your best interest to comply with this requirement. See me if you have any questions about this new requirement. This requirement is not expected to be repealed.

1099 reporting for all business. This requirement has also been kept a bit quiet, but was part of the Health Care Law. It does not take effect until 2012, and is widely expected to be repealed or at least significantly

modified. But if it is not repealed it will be a very burdensome reporting requirement on small business. This requires 1099 reporting for all payments totaling more than \$600 to any individual, business, or corporation a business pays money to during the year. So, you should expect to possibly have to obtain form W9 from your vendors before the beginning of 2012, so you can report this information on form 1099.

Credit Card reporting. Also, beginning in 2011 to be reported in January of 2012 there is a requirement that credit card merchant companies report how much was paid to merchants. This is to let the IRS know how much each and every business collects from credit card sales. It does not apply to individuals regarding how much you charge on your credit cards. But if you have a business and accept credit cards, the total amount you accept in credit card payments will be reported. This also applies to some other third party payers which mostly means PayPal. So if you accept credit card or PayPal payments, the amounts will be reported to the IRS.

Standard mileage allowance. The standard mileage allowance for 2011 climbs up to .51 from the .50 allowed for 2010. The rate for medical mileage goes to .19 per mile and the rate for charitable driving remains at .14 per mile.

Cell phones. Cell phones used in business are no longer considered "listed property" which means that the strict substantiation requirements you had to follow regarding personal use are no longer required. This is good news since I have yet to find anyone who seemed to be able to follow any such requirements. Employee use of business cell phones is now considered a tax free fringe benefit.

HSA penalties. The penalty to withdraw funds from an HSA or MSA have increased to 20% if the withdrawals are not used for qualifying medical expenses.

Health Care law. Most of the provisions of the health care law do not take effect for a couple of more years. Therefore, I only mention a few items in this newsletter which are likely to have an effect on us in the near term. About the only things that are clear is that it will be very expensive for the government and will increase the costs for health care for almost everyone. It is much too difficult to do much planning regarding the health care law as it stands, because of the expectation that substantial portions of it will be repealed, changed or judged unconstitutional. We will continue to watch it carefully over the next couple of years. When we are a bit more confident what the ultimate look of the law will be, we will make suggestions regarding

how to minimize the costs associated with it as well as how to take advantage of potential tax benefits.

Health Insurance Credit. There is a new credit for small employers providing health insurance for their employees. There are two separate sets of rules for employers with less than 10 full time employees and employers with less than 25 full time employees. If you fall into one of those categories, we will discuss the possibilities of this credit.

Health Insurance Deduction. If you are self employed in 2010 your health insurance is deductible not only for income tax computation but also for self employment tax computation for 2010 only. This benefit goes away for 2011.

Health Insurance reporting. Beginning in 2011 (W2 forms received in 2012), employers will be reporting on the W2 form the value of health insurance provided by the company. Some employers will be doing this early on 2010 W2 forms. This has widely been reported on the internet as an attempt to tax your health insurance benefits. Do not believe much of what you hear on the internet. This is for information purposes only. It is not taxable income to the employee.

Home Sales Tax. While on the subject of internet rumors, there is one circulating that there is a 3.8% sales tax on selling your home. This is a significant distortion of an increase in the medicare tax in a very limited set of circumstances. First, there is no sales tax on the sale of a home. There is an increase in the medicare tax for investment income in certain situations. First, your adjusted gross income must exceed \$200,000 if single and \$250,000 if married filing joint. Next the sale of one's home will only be affected if the profit on the sale of the home exceeds \$250,000 (single) or \$500,000 (married filing joint). This effectively limits the effect of this tax to much less than 1% of the people who sell their homes and it would only be assessed on the profits in excess of \$250,000/500,000. The existence of this additional medicare tax is a consideration for high income individuals with investment income.

Adoption Credit. The adoption credit has been increased by \$1,000 to \$13,170 per eligible child and has been changed to a refundable credit for 2010.

How can I reduce taxes? Some of the best ways you can reduce taxes are to maximize your deductible retirement plan contributions and HSA contributions. These not only reduce taxes now, but allow you to put money aside in investments for which the current earnings are tax deferred. If you

or your children are in college, there are a variety of education related tax benefits. Each individual has different circumstances and different opportunities to reduce the tax burden. Discuss these possibilities with me during your tax appointment or at any time during the year.

Investing in metals. More and more people are putting a portion of their investment dollars in precious metals, mostly silver and gold. These may be good investments, but most investment advisors recommend between 10 and 20 percent of your investments be in these metals. Also, from a tax perspective, these investments do not qualify for the reduced capital gains tax rates. This higher tax rate on the profitable sale may reduce the advantages these products have as an investment. There may be other reasons to put money into metals, and I would be happy to discuss these with you.

Bank accounts. Are you starting a new business or forming an LLC, corporation, or partnership? By all means, open a new bank account in the name and tax identification number of the venture. When IRS audits a business, the fact that there is no separate business account weighs against the taxpayer and can result in the loss of the tax benefits sought via the LLC, corporation, or what-have-you. It also can open you up to losing the limited liability protection you may have been seeking with the organization. A bank account may also assist in helping to make it clear that your business is a business rather than a hobby.

Organizers and Appointments. Organizers will be going out shortly and are also available on our website to assist you in getting information together necessary to prepare your tax returns. Please use them to assure that you get all the appropriate information together. There are also a number of other forms available on the website which may be helpful, particularly the non-cash charitable contribution forms. Please call to schedule your appointment as soon as possible. We are available most days if necessary. We do schedule most appointments for early morning, the evenings, or on Saturdays to try to work with your schedules. Make sure you have all information available prior to your appointment.

The following are a few items I find need to be repeated at least every year. Please keep these issues in mind:

Charitable Contributions. All cash contributions require at least a bank record or a receipt from the charity. Cash contributions may no longer include small amounts given to bell ringers or put into collection plates unless there is a receipt from the charity. There must be a cancelled check or receipt for contributions of less than \$250.00 For all contributions of

\$250 or more, there must be a receipt; a cancelled check will not suffice. The IRS continues to be more hardnosed about this. The receipt must state that you did not receive anything of value in return for the contribution.

Business meals. As a reminder meal expenses are considered personal and non-deductible. Expenses for lunches or other meals for yourself when away from the office or out of town while on business are not deductible. Meals where you entertain customers or vendors must have the date, and a notation of the individuals present along with the business information discussed noted on the receipt. In this case 50% of the amount spent on the meal is deductible. 100% of the tip will be deductible if separately stated. Meals provided to employees such as for company picnics/parties or in conjunction with overtime work are 100% deductible.

Business mileage. There are strict rules concerning business mileage. Following is information you must provide if you are claiming either business mileage or taking actual expenses on a vehicle:

- average daily round trip commuting distance
- Total commuting mileage for the year
- Total mileage put on the vehicle for the year
- Number of miles the vehicle was used for business
- Do you have evidence to support your deduction?
- Is the evidence written in a log of some sort?

Guess who gets audited if you answer no to either of these last two items? And no, we cannot fib for you or provide approximations out of thin air. You must keep adequate records of mileage.

Homework. It is not uncommon for clients to leave their tax appointment with "homework"-a list of information the tax preparer still needs in order to complete the return. Please provide this homework as soon as possible to avoid backlogs or delays in processing your returns. If homework is not furnished before March 15, you can expect that your return will be placed on extension. Note that you still must pay your taxes by April 15 even if you are on extension. Also, any clients who have not signed the electronic filing authorizations prior to April 10 will have their returns put on extension.

Our Newsletters. This newsletter as well as all our newsletters, organizers, website, and other documents are general in nature. No transaction should be completed without a professional consultation on its ramifications. Please pass this newsletter along to a friend or colleague when you have finished, or phone for an extra copy. Recent newsletters are also posted on our website.

New Clients. We thank you for the many nice referrals that you have sent to us over the past years. We have increased the amount of time available for new clients over the next year. This has opened up more capacity for income tax clients. So please keep us in mind if any of your friends, relatives or colleagues express a need for professional tax assistance. Good referrals are always appreciated. We are also expanding our business advisory and process improvement services. We are available on a year round basis for income tax, estate planning, business planning, process improvements, and personal financial planning consulting.

The Fam. For those of you acquainted with us and have expressed interest in the doings of the family here are a few quick pieces of information from the past year. Josiah and Beka added Joy to the family on October 14. His (Josiah's) business continues to be exciting and dynamic. Maria is in her second year of medical school at Rocky Vista University in Parker, CO. She will be a doctor in less than 3 years. Hannah finished college with a degree in communications and is developing her career in event planning as well as an internet based business. She has also done some excellent work as a photographer. If you need a photographer, she would be worth checking out. Honami is working on her thesis in Toyohashi. Susan has been enjoying playing in her garden and homemade hothouse (we picked fresh ripe tomatoes when it was -5 outside) as well as being Nonni. A copy of the Gallo family cookbook is available to anyone who asks for it.