

the Competitive Edge

Summer 2010

Brace Yourself for a Sea of Change in the Tax Law

A number of tax law changes are making their way through Congress, and many more are on the way. These changes will affect both individual and business taxpayers alike. In 2010 it is expected that Congress will address the federal estate tax, and is currently working on small business and jobs “relief,” as well as an extension of popular, but temporary tax incentives that expired at the end of 2009. Following is a brief overview of what taxpayers can expect this year.

Individual and Business Tax Extenders

Congress continues to debate the extension of a number of tax incentives for individuals and businesses that expired at the end of 2009. The tax breaks would be extended retroactively for one year, through December 31, 2010. A number of popular energy tax incentives and charitable deductions would be extended too. Among the individual incentives that would be extended are the popular additional standard deduction for real property taxes, the state and local sales tax deduction, and the higher education tuition deduction, as well as the teacher’s classroom expense deduction.

For business taxpayers, some of the tax incentives to be extended include the research tax credit, New Markets Tax Credit, differential pay credit, and the



15-year recovery period under the Modified Accelerated Cost Recovery System (MACRS) for qualified leasehold improvements, and qualified restaurant and retail improvement property.

A host of charitable and energy tax incentives would also be extended through 2010. The charitable extenders include the ability to make a charitable IRA contribution of up to \$100,000 for individuals age 70 1/2 and older, and the tax deductions for contributions of real property, food inventory, computer and book inventory to public schools, and S corporation charitable contribution deductions.

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DOEREN MAYHEW
Certified Public Accountants and Consultants

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Small Business Tax Relief/“Jobs” Bill

The House has twice passed a package of small business tax incentives. The bill includes three major incentives for small business: (1) a 100 percent exclusion of gain from the sale of qualified small business stock, (2) an enhanced deduction for start-up expenses, and (3) penalty relief for taxpayers that failed to disclose transactions with the potential for tax evasion. The Small Business Jobs Tax Relief Act of 2010, passed by the House in June, would increase the exclusion for qualified small business stock sold by an individual from 75 percent to 100 percent for stock acquired after March 15, 2010, and before January 1, 2012.

Increased start-up expenses. The bill increases the deduction for qualified start-up expenses from \$5,000 to \$20,000. It also increases to \$75,000 the threshold amount by which the \$20,000 deduction would be reduced.

Decreased Code Sec. 6707A penalties.

The legislation would also provide for lower penalties under Code Sec. 6707A for taxpayers who fail to disclose “reportable transactions” in which they participate. This change is intended to help ameliorate the impact of the penalty on small businesses, which can currently reach a maximum of \$200,000 for businesses failing to report listed transactions and \$50,000 for failing to report reportable transactions. Many businesses have been assessed these penalties for engaging in transactions they did not know were tax shelters.

New limits on GRATs. To pay for the small business tax incentives, the bill places new limits on grantor retained annuity trusts (GRATs), a popular estate and gift planning vehicle. GRATs would be required to have a minimum 10-year term, carry a remainder interest

with a value greater than zero, and prohibit any decreases in annuity payments during the GRAT’s term. The new limits would be imposed for transfers after the date of enactment.

3.8 Percent Medicare Tax on Investment Income

The health care reform package (the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010) imposes a new 3.8 percent Medicare contribution tax on the investment income of higher-income individuals. The tax will apply to the lesser of net investment income or modified adjusted gross income above \$200,000 for individuals and \$250,000 for joint filers and surviving spouses, and \$125,000 for married couples filing separate returns.

Although the tax will not take effect until 2013, it is important for individuals who will be affected by the tax to start examining ways to lessen the impact now. Net investment income includes interest, dividends, annuities, royalties, rents, and other gross income attributable to passive activities. Gain from the sale of property not used in an active business (for example, your personal residence) and income from the investment of working capital are also treated as investment income. The tax won’t apply, however, to nontaxable income such as tax exempt interest, or to veterans’ benefits. An individual’s capital gains income will be subject to the tax. This includes gain from the sale of a principal residence, unless the gain is excluded from income.

A significant exception to the 3.8 percent Medicare tax applies for distributions from qualified plans, 401(k) plans, tax-sheltered annuities, individual retirement accounts (IRAs), and eligible 457 plans. These will not be subject to the tax.

Interplay with other tax changes. In addition to the 3.8 percent Medicare tax, taxpayers also face other tax

increases taking effect in 2011. The top two marginal income tax rates for individuals will rise from 33 and 35 percent to 36 and 39.6 percent, respectively. The maximum tax rate on long-term capital gains is set to increase from 15 to 20 percent. Dividends, which are currently capped at the 15 percent long-term capital gains tax rate, will be taxed at ordinary income tax rates.

Estate Tax Fix

The federal estate tax does not apply to decedents dying after December 31, 2009, and before January 1, 2011. Also, beginning in 2010, the stepped up basis at death rules are replaced with modified carryover basis at death rules applicable to estates holding assets with unrealized capital gains of more than \$1.3 million. In December 2009, the House passed the Permanent Estate Tax Relief Act, which would permanently extend the top federal estate tax rate of 45 percent with a \$3.5 million exclusion (\$7 million for married couples). The Senate, however, has failed to take up the House bill. Some action this year is expected. The estate tax will revert to a 55 percent tax rate beginning in 2011. Proposals in Congress range from setting the exemption level at \$5 million for individuals and reducing the tax rate to 35 percent.

Doeren Mayhew Can Help

These are just the highlights of what both individual and business taxpayers can expect this year. Doeren Mayhew will continue to monitor the tax law changes and will keep you updated on any significant developments. In the meantime, please contact your Doeren Mayhew representative if you have questions regarding any of the tax law changes mentioned in this article.

Navigating Revised Payroll Form 941 to Maximize Your HIRE Credit

The IRS has revised Form 941, Employer's Quarterly Federal Tax Return, and its instruction to reflect the payroll forgiveness tax credit provided by the Hiring Incentives to Restore Employment (HIRE) Act. Form 941 was revised for use beginning in the second quarter of 2010. If you are claiming the credit for the second quarter, the deadline to file revised Form 941 to claim payroll tax forgiveness is quickly approaching: the second calendar quarter of 2010 ended June 30, 2010, and Form 941 is due by July 31 (August 2, 2010, under the weekend rule).

Payroll Tax Forgiveness

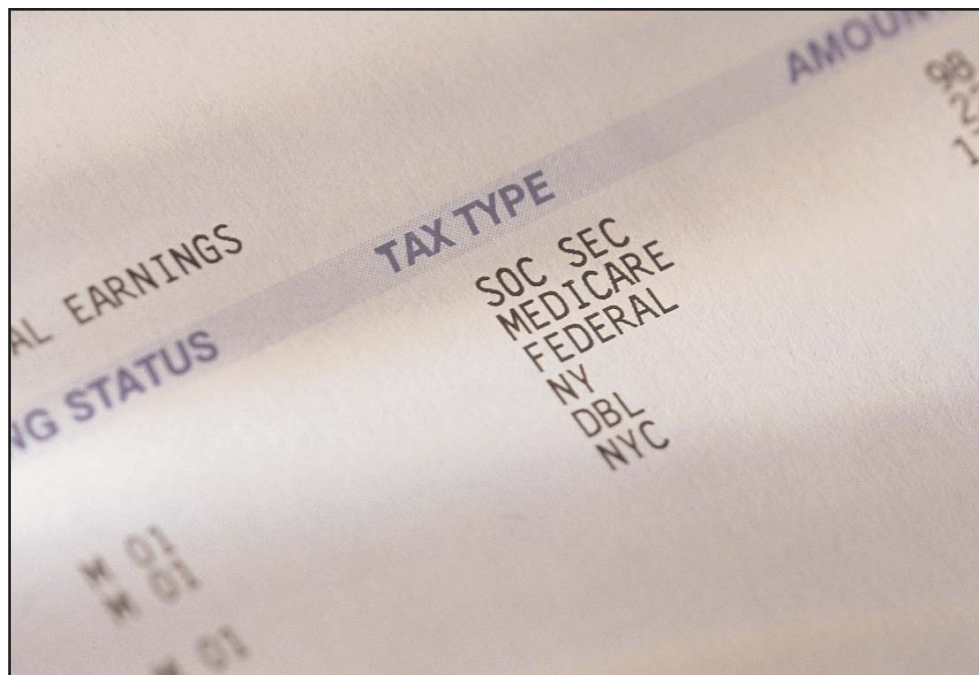
In brief, the HIRE Act provides qualified employers with payroll tax forgiveness. Qualified employers are exempt from the employer's 6.2 percent share of Social Security tax on all wages paid to covered employees from March 19, 2010, through December 31, 2010. To qualify, covered employees must begin work after February 3, 2010, and before January 1, 2011.

Claiming the Credit for the Second Quarter

The payroll tax exemption is claimed on the revised Form 941 beginning with the second quarter of 2010. The HIRE Act does not allow employers to claim payroll tax forgiveness in the first calendar quarter, thereby providing for a credit in the second quarter. You may also claim the payroll tax exemption for wages paid from March 19, 2010, through March 31, 2010, on Form 941 for the second quarter of 2010.

Revised Form 941

The revised Form 941, to be used by employers to claim payroll tax forgiveness under the HIRE Act for



qualifying new hires, includes a number of new lines and asks a set of new questions for purposes of the credit. New lines on Form 941 include:

- **Line 6a:** Number of qualified employees first paid exempt wages/tips this quarter
- **Line 6b:** Number of qualified employees paid exempt wages/tips this quarter
- **Line 6c:** Exempt wages/tips paid to qualified employees this quarter
- **Line 6d:** Payroll tax forgiveness this quarter
- **Line 12c:** Number of qualified employees paid exempt wages/tips March 19 - March 31, 2010
- **Line 12d:** Exempt wages/tips paid to qualified employees March 19 - March 31, 2010
- **Line 12e:** Payroll tax forgiveness March 19 - March 31, 2010

Line 6b asks employers to report the total number of covered employees paid exempt wages/tips to which they applied the Social Security exemption in this quarter. On Line 6c, you enter the amount of exempt wages/tips paid this quarter to all covered employees reported on Line 6b. Employers multiply the amount of exempt wages/tips reported on line 6c by .062 and enter the result on Line 6d. Lines 12c, 12d, and 12e will be on the Form 941 for the third and fourth quarters, but apply only for the second quarter.

Form 941 Instructions

The instructions for the new Form 941 explain how this credit for wages paid from March 19 through March 31 can be claimed on the second quarter return. The IRS also explained how qualified employers will report the payroll tax exemption on Schedule B, Report of Tax Liability for Semi-weekly Schedule Depositors.

Common IRA Contribution and Distribution Mistakes

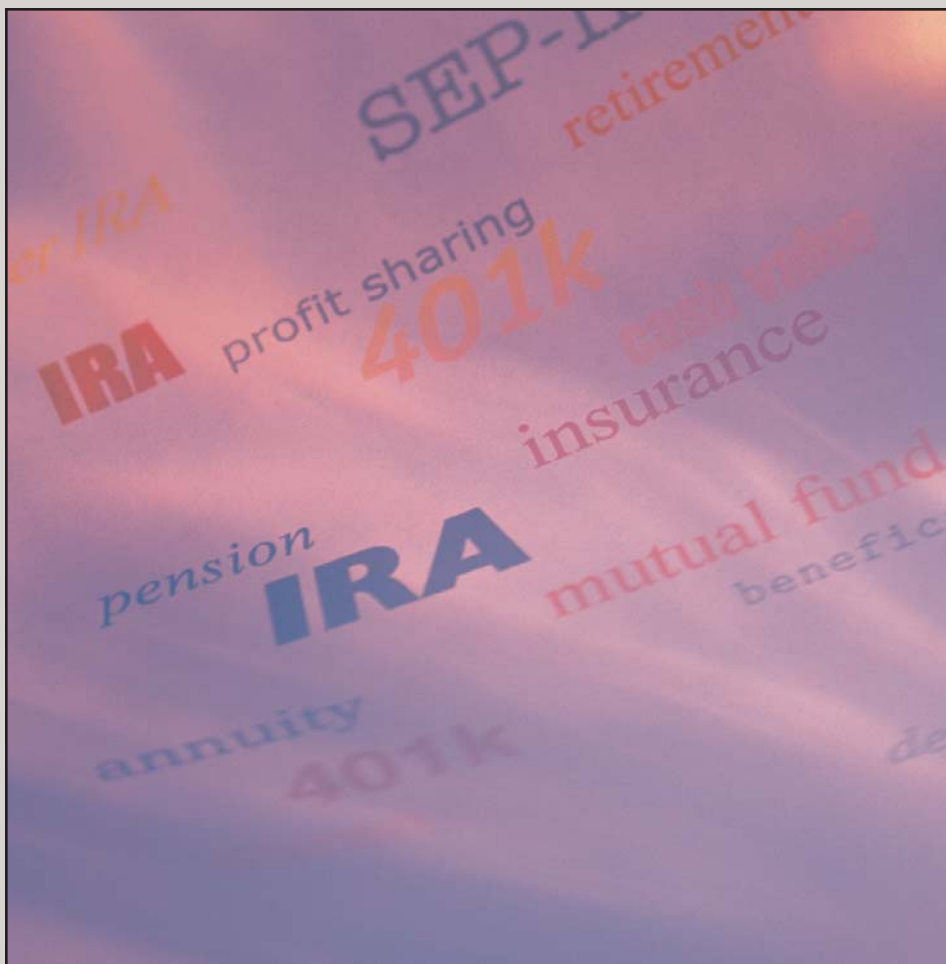
Individual retirement accounts (IRAs) – both traditional and Roth IRAs – are among the most popular retirement savings vehicles today. Protecting the value of your IRA (and other retirement accounts) is incredibly important. While some factors affecting the value of your retirement savings may be out of your control, there are many things within your control that can help you safeguard the wealth of those accounts and further their growth. This article addresses common mistakes regarding IRA distributions and contributions, and how to avoid them.

A recent report by the Treasury Inspector General for Tax Administration, which oversees IRS activities through investigative programs, reports that an increasing number of taxpayers are not complying with IRA contribution and distribution requirements. Mistakes include, among other things, making excess contributions that are left uncorrected or failing to take required minimum distributions from their IRAs.

Making Excess Contributions

Knowing the maximum amount that you can contribute to your IRA is imperative to avoid negative tax consequences. A 6-percent excise tax applies to any excess contribution made to a traditional or Roth IRA. In 2010, individuals can contribute up to \$5,000 to both traditional and Roth IRAs. Individuals age 50 or older can also make “catch-up” contributions of up to \$1,000 to their IRA in 2010 as well.

If you withdraw the excess contribution amount on or before the due date (including extensions) for filing your federal tax return for the year, you will not be treated as having made an excess contribution and the 6-percent excise tax will not be imposed. You must also withdraw any earnings on the contributions as well.



Not Contributing Enough

On the opposite end of the spectrum, you may be contributing too little to your IRA. Although your financial and personal situation will dictate how much you contribute to your IRA each year, and whether you are able to contribute the maximum amount, there are benefits to making the maximum contribution. Contributing the maximum amount means larger tax-free or tax-deferred growth opportunity for your dollars, and a higher account value upon retirement. Moreover, contributing more to your traditional IRA means a larger tax deduction come April 15. Thus, failing to contribute the maximum allowable amount means

you may be missing out on tax deductions in addition to tax-deferred, or tax-free earnings.

Not Taking Your RMDs

Required minimum distributions (RMDs) are minimum amounts that a traditional IRA account owner must withdraw annually beginning with the year that he or she reaches age 70 1/2. The RMD rules also apply to 401(k) plans, Roth 401(k)s, 403(b) plans, 457(b) plans, SIMPLE IRAs, and SEP IRAs. However, Roth IRAs are not subject to RMD rules (beneficiaries of Roth IRAs must take RMDs, however).

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If you fail to take a RMD, or fail to take the correct amount for the year, the IRS imposes a 50 percent penalty tax on the difference between the actual amount you withdrew and the amount that was required. This is a stiff penalty to pay. A specific formula is used to compute annual RMDs, based on your current age, the amount in your IRA as of a certain date, and your life expectancy. Generally, RMDs are calculated for each account (if more than one) by dividing the prior December 31 balance of the IRA (or other retirement account) by a life expectancy factor that the IRS publishes in Tables in IRS Publication 590.

RMDs were suspended for the 2009 tax year, in order to help retirement plans hit by the economic downturn. However, individuals must begin taking RMDs again in 2010 and thereafter.

Failing to Rollover IRA Funds Within 60 Days

If you receive funds from an IRA and want to roll over the money to another IRA, you have only 60 days to complete the rollover in order to escape paying taxes on the transaction. In general, failing to complete a rollover from one IRA to another within the 60-day window has significant tax ramifications. If the funds are not rolled over within this timeframe, the amount is considered taxable income, subject to ordinary income tax rates. And, if you are younger than age 59 1/2, you will pay an additional 10 percent tax. The distribution may also have state income tax consequences as well. (Rollovers from traditional IRAs to Roth IRAs are taxable, regardless of whether they are completed within 60 days.) If you have the option, make a direct rollover or transfer. A direct

trustee-to-trustee transfer involves your funds being directly rolled over from one financial institution to the other, avoiding the 60-day requirement since you never directly receive the money.

Also, you can generally make a tax-free rollover of amounts distributed to you from IRAs only once in a 12-month period. As such, you can not make another rollover from the same IRA to another IRA (or from a different IRA to the same IRA) for one year without the amount being subject to tax. And, individuals age 70 1/2 or older cannot roll over any RMD amounts. Make sure that if you must take an RMD for the year, you withdraw the amount prior to rolling over the IRA.

Make Roth IRA Contributions After Age 70 1/2

If you continue earning income after reaching age 70 1/2, you can continue contributing to your Roth IRA, on top of not having any RMD requirement. Therefore, you continue to accumulate tax-free savings. If you have earned income, and your financial and personal situation allows, consider continuing contributions to your Roth, building up tax-free money when you withdraw the funds.

Failing to Name an IRA Beneficiary

Don't make the mistake of neglecting to name a beneficiary for your IRA. IRAs do not pass by will, but rather pass under the terms of an IRA Beneficiary Designation Form. If you have not named a beneficiary of your IRA, such as your spouse or child(ren), the "default" beneficiary usually is the account holder's estate. Where there is no named beneficiary, distributions from the IRA must then generally be made as a lump sum or within five years after the owner's death.

When you designate your child(ren) as the IRA beneficiary, the rules regarding distributions differ

from those that govern IRAs held by a surviving spouse beneficiary. Non-spouse IRA beneficiaries must generally begin taking required distributions over their life expectancy or within five years after the IRA owner's death. Although taking required distributions, the undistributed IRA assets continue to grow in a tax-deferred manner. On the other hand, a surviving spouse beneficiary may elect to treat the IRA as his or her own, or take minimum distributions as a non-spouse beneficiary would.

Distributions from inherited IRAs are taxable to the recipient as ordinary income. Generally, the income tax rate tends to be higher when an IRA is paid to the estate instead of an individual beneficiary.

Roth IRA Conversions

This year may be the first time you are eligible to convert your traditional IRA to a Roth. Beginning in 2010, any individual regardless of adjusted gross income (AGI) or filing status can take advantage of a Roth IRA conversion. Prior to 2010, the ability to convert a traditional IRA to a Roth was limited to individuals with AGIs of less than \$100,000. Also, married individuals filing a separate return could not convert to a Roth IRA either. If you convert in 2010, you can elect to split (and defer) the tax you will owe on the conversion and pay half in 2011 and half in 2012.

The decision to convert to a Roth IRA depends on many factors, including the financial and tax consequences of the transaction. Sometimes, it may be wiser depending on your situation to stick with your traditional IRA, especially if you will pay more tax on the conversion than in the account, or you don't have outside funds to pay for the conversion tax. Do the math carefully and talk with Doeren Mayhew's tax advisors beforehand.

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Doeren Mayhew Merges With Houston-Based CPA Firm T.R. Moore & Company

The directors of Doeren Mayhew are pleased to announce its merger with Houston-based accounting and consulting firm T.R. Moore & Co. P.C.

T.R. Moore & Company was founded in 1984 and has been serving privately-held, mid-sized businesses in multiple industries since its inception. The firm has four partners and 40 associates, all of whom will become Doeren Mayhew employees. T.R. Moore & Company will continue to operate as normal out of its Houston-based office to service clients. Doeren Mayhew will remain headquartered in Troy and will now have 245 employees in two states.

Both firms have adhered to the same core business principals that have provided them national recognition on the "Best of the Best" list by *INSIDE Public Accounting*, which ranks the top 50 U.S. accounting and consulting firms. T.R. Moore & Company is one of the true rising stars of the profession, having debuted on the *INSIDE Public Accounting* "Best of the Best" list in 2003 as one of the smallest firms ever to have made the prestigious list, and was one of just two firms with fewer than 40 professionals to be included on the list in 2009.

This merger will allow Doeren

Mayhew to add energy to its list of serviced industries while T.R. Moore & Company's clients will benefit by having access to more resources, including audit expertise, international tax, corporate finance, strategic planning, wealth management, and payroll processing. Doeren Mayhew will also be able to increase its national reach and continue on a pattern of sustained growth. Given our mutual vision of service and growth, along with shared recognition as best-managed firms, we look forward to what we can collectively accomplish for our clients and staff.