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CERTIFIED PUBLIC ACCOUNTANTS

The Accountant's Corner

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Inside This Issue

Health Care Reform Update

This spring, President Obama signed the Patient Protection and Affordable Care Act into law. As most Americans are well aware, this health care reform legislation is expansive and complicated. Therefore, we will only cover some of the provisions related to tax for both businesses and individuals. Moreover, parts of the legislation are still several years away from being put into place and may be changed before they actually have an effect on our health care system.

Congress and the President felt a need to help small businesses with the ever-increasing cost of providing health care to their employees. The new law provides a credit up to 35% of health care premium costs through 2013 for employers with 25 or less employees and average annual wages of less than $50,000. Tax-exempt companies can receive up to 25% of the premiums paid through 2013 if they meet the same limits mentioned above. For 2014 and beyond the credit increases to 50% and 35% for taxable and tax-exempt small businesses respectively.

As with any legislation, Congress has to find a way to pay for it. Beginning in 2013, there will be a 3.8% Medicare tax on investment income from interest, dividends, royalties, rents, income from passive activities and net gain from disposition of property for individuals earning over $200,000 and joint filers earning over $250,000. In essence, this is a payroll tax on non-wage income.

As of 2011, the penalty on distributions from a health savings account that are not used for qualified medical expenses is raised from 10% to 20%. Effective 2013, contributions to flexible spending accounts are capped at $2,500 annually. Beginning in 2011, over-the-counter medications will no longer be reimbursed through health flexible spending accounts. In 2013, the threshold for claiming the itemized deduction for medical expenses increases from 7.5% to 10% of adjusted gross income. Also, for tax years beginning after 2010, employers must include the aggregate cost of employer-sponsored health coverage (not including Archer MSAs, HSAs, or health FSAs) on form W-2. These seemingly minor changes could have an effect on your health care planning going forward.

The Internal Revenue Service is in the process of issuing additional guidance with regards to many of these new provisions.

Please contact us with any questions related to the new health care law.

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Provision to the Health Care Reform Act

In a little noticed provision of the Health Care Reform Act, all businesses will be required to issue 1099's to all corporate and noncorporate providers of property and services beginning in 2012. The government hopes that this new reporting requirement will help raise additional revenue. The only thing that will be raised for certain is the paperwork requirements for businesses of all sizes. We will keep you updated on any changes to this reporting requirement.

Taxing Social Security Benefits

Although individual taxpayers must pay tax into the Social Security system during their working years, that is not the end of the line. Depending on their income, they may also be liable for tax on Social Security benefits received in retirement.

Background: For 2010, the Social Security “wage base” is $106,800 (the same as it was for 2009). In other words, an employee must pay the 6.2% FICA portion of Social Security tax on the first $106,800 of wages. The 1.45% Medicare portion of the tax applies to all wages. These figures are doubled for self-employed taxpayers (although half of the self-employment tax is tax-deductible).

That is pretty straightforward. Conversely, the rules for taxing Social Security benefits received in retirement are considerably more complicated.

For starters, an individual’s “provisional income” determines his or her tax liability, if any. Provisional income is defined as:

- modified adjusted gross income (regular AGI)
- plus any tax-exempt income received
- plus one-half of the Social Security benefits received

If provisional income is less than the annual “base amount,” none of the benefits are taxable. The 2010 base amount is $32,000 for joint filers; $25,000 for single filers. (For married taxpayers filing separate returns, the base amount is zero.)

However, if provisional income exceeds the base amount, the recipient is taxed on Social Security benefits. The amount depends on whether either one or two thresholds are surpassed.

1. If provisional income is between $32,000 and $44,000 ($25,000 and $34,000 for single filers), tax is paid on the lesser of (a) one-half of the Social Security benefits or (b) 50% of the amount by which provisional income exceeds $32,000 ($25,000 for single filers).

Example: Linda Green is a joint filer; her provisional income is $40,000, and she receives $10,000 in annual Social Security benefits. In this case, she must pay tax on $5,000, since half of the benefits received exceed half of the excess over the base amount, or $4,000. If Linda is in the 25% tax bracket overall, she must pay $1,250 of tax on her benefits.

2. If provisional income is more than $44,000 ($34,000 for single filers), the calculation is more complicated. The recipient must pay tax on 85% of the amount by which provisional income exceeds $44,000 ($34,000 for single filers) plus the lesser of (a) the amount determined under the first threshold or (b) a base amount of $6,000 ($4,500 for single filers). In no event, however, can the amount exceed 85% of the benefits received.

Note that investments generating tax-exempt income, such as municipal bonds or municipal bond funds, may increase provisional income. This category may also include interest on U.S. Savings Bonds used to pay college tuition.

This is a complex area of the tax law, and it could have an impact on retirement decisions. Please contact our office if you have any questions regarding the taxes on your Social Security benefits.

Sensible Estate Planning for Business Owners

The uncertainty over the future estate-tax law has put many business owners-not to mention their advisers-in a bind because Congress has not yet passed any legislation defining the estate tax laws for 2010. Yet one of the worst things to do is to completely ignore the situation. This is especially true if a business owner is contemplating retirement or a sale of the business, or both, in the upcoming years.

Conversely, a comprehensive plan emphasizing flexibility can minimize potential estate-tax liability, regardless of any changes in the estate-tax law that may be enacted. Moreover, an estate plan may avoid a “distress sale” of a business interest while preserving assets for the owner’s heirs.

The initial step is to identify the objectives of the estate plan. Determine the benefits to be derived, the risk assumptions and the amount needed to sustain a comfortable retirement. Once these goals have been established, professional advisers can help formulate the best way to achieve them.

Next, provide the advisers with an inventory of assets. This can be accomplished simply by listing all the assets owned in addition to the business interest (e.g., real estate, stocks, bonds, bank accounts, life insurance, etc.). The advisers can make a reasonable projection of the future net worth of these assets.

The plan may also utilize a buy-sell agreement providing a blueprint for the future sale. Such an agreement may facilitate a transfer of power to the younger generation or a sale to outsiders.

continued on page 3

Cobra Premium Reduction Extended

Congress and the President have extended assistance with COBRA premiums for eligible individuals through May 31st of this year. The premium reduction allows “assistance eligible individuals” to pay only 35% of their premiums for up to 15 months. Employers pay the rest and are reimbursed through an employment tax credit. Businesses must notify current and former participants and beneficiaries if they might be eligible for this premium reduction or face penalties. Please contact our office if you have any questions relating to your obligations under this legislation.

The HIRE Act

The Hiring Incentives to Restore Employment Act (HIRE) was recently signed into law as the first major tax bill of 2010. Under the HIRE Act, employers are exempt from the employer's 6.2% share of social security tax on all wages paid to qualified newly hired employees who begin employment after 2/3/10 and before 1/1/11. The employee must still pay their portion of the tax and this act will have no effect on the employee's future social security benefits. The employer and employees share of Medicare tax still applies to all wages. We put together a list of frequently asked questions regarding this legislation.

Which employers qualify? Taxable businesses and tax-exempt organizations qualify for the exemption. Household employers are NOT eligible.

Which employees qualify? Employees must have been unemployed or employed for less than 40 hours during the 60-day period ending on the date employment began. Employees do NOT qualify if they are family members of the employer.

How do I verify prior unemployment? The employee must sign an affidavit verifying their previous employment status. This form does not need to be sent to the IRS, it must be kept on file by the employer.

How do I claim the credit? The credit is reported on Form 941. The employer can choose between not submitting the 6.2% with their deposits, or making the deposits as usual and claiming a refund at the end of the quarter. Eligible wages paid between 3/19/2010 and 3/31/2010 will be claimed on the 2nd quarter 941 and a refund will be given.

How do I track this information in my accounting software? Most accounting packages are still trying to catch up at this point, so it is likely that this information will have to be tracked manually for the time being. Quickbooks is hoping to issue an update in the near future to address the issue. Until that time, QuickBooks clients should continue to record payroll as usual in QuickBooks and make a manual adjustment to their deposits, or continue to pay in the deposits and claim the refund on the 2nd quarter 941 form. QuickBooks will include instructions with the update on how to adjust wages previously paid.

Other things to keep in mind:

Employers cannot claim both the 6.2% HIRE credit and the Work Opportunity Credit. If employers are going to claim a certain employee under WOTC, they need to opt out of the HIRE credit. The client should calculate which option will be more beneficial to them as it will depend on the wage level of the employee as well as expected length of employment. It is not necessary for individuals to have been previously employed to claim this credit. For example, a student just entering the workplace would still qualify for the credit. A new hire cannot replace an existing worker UNLESS the existing worker terminated employment voluntarily or was terminated for cause.

In addition to the 6.2% social security tax exemption, if the qualified employee is retained for at least 52 consecutive weeks, the business will also be eligible for a general business tax credit of 6.2% of wages paid to the qualified employee over the 52 week period, up to a maximum credit of $1,000. This New Hire Retention Credit will be claimed on the employer's 2011 tax return.

Sensible Estate Planning for Business Owners

continued from page 2

Seeking to minimize potential estate taxes is more problematic in the current environment. At the crux of the matter is the scheduled repeal of the federal estate tax for 2010. This is to be followed by a restoration of the tax in 2011 with a less favorable exemption and revision of the "carryover basis" rules for inheritances. However, even during this period of uncertainty, business owners may benefit from the use of the unlimited marital deduction and astute trust arrangements for family members.

Furthermore, the size of a business owner's estate may continue to be reduced through lifetime gifts. For 2010, the annual gift-tax exclusion covers gifts of up to $13,000 per recipient, before any portion of the $1 million lifetime gift-tax exemption is used. Also, special estate-tax breaks for business interests may be available. For instance, the federal estate tax due on a large business interest may be spread out over a 14-year period if certain conditions are met.

Life insurance often can be part of the plan. In particular, business owners may rely on life insurance for its liquidity. If the policy is structured carefully, the proceeds can be received free of both estate and income taxes.

Of course, this general overview does not take any extenuating circumstances into account. Please feel free to consult with our office if you have any questions regarding estate or gift planning.

Please note that this newsletter was sent to many of our clients via email in addition to the regular print version. If you would prefer not to receive the email version, please contact Carol Wilson (carol.wilson@tjtpa.com) at our office to take your name off the email list. If you would prefer to only receive the email version, please contact Carol and we will adjust our mailing list accordingly.