SUMMER 2011

TAXOLUTIONS

ideas on taxes

Keeping Land in the Family with Conservation Easements

A conservation easement is a voluntary legal agreement between a landowner and another party, usually a government agency or nonprofit trust, which restricts the use of the land in perpetuity, even as the land remains the private property of the landowner and can be sold or passed on to heirs. In addition to enabling them to specify how they wish the land to be used, conservation easements can be helpful to farmers, ranchers, and other large landowners as a means of reducing their income taxes and of lowering the value of their estate for tax planning purposes. In many cases, the creation of a conservation easement can avert the need of the owner or the owner's heirs to sell or subdivide the land to cover tax liabilities after death.

Generally, a conservation easement agreement is made between a landowner and a Federal, state, or local government agency, or a qualified land protection organization, such as a land trust. While these agreements vary, they generally restrict real estate development, commercial and industrial uses, and certain other activities on the property, while preserving the land for conservation purposes specified in the agreement. The agreement may, for example, specify that the land is used for farming or forestry, as a natural habitat for wildlife, or as a scenic or recreation area accessible to the public. In some cases, the conservation easement preserves a piece of land or a building that has been certified as historic, including the historic façade of a building.

Tax Benefits

Because the land or building can no longer be used for development, conservation easements generally result in a significant reduction in the market value of the property. This difference in value is the basis for awarding tax incentives to landowners who preserve land or buildings for future generations. Under Section 170(h) of the Internal Revenue Code, landowners may be eligible for a Federal income tax deduction equal to the value of their easement donation, as determined by a qualified appraiser. The value of the easement donation is equal to the difference between the fair market value of the property before and after the easement went into effect.

Since the passage of the Pension Protection Act of 2006, conservation easement donors have been permitted to deduct the value of their donation at the rate of 50% of their adjusted gross income (AGI) per year, up from 30% previously. In addition, farmers and ranchers who derive 50% or more of their income from agriculture are allowed to deduct

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Expansion of 1099 Reporting Requirements Repealed

On April 14, 2011, President Obama signed into law an amendment that repeals an expansion of 1099 reporting requirements for businesses that had been slated to go into effect in 2012.

The Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011 repeals Section 9006 of the Patient Protection and Affordable Care Act of 2010 (PPACA), a provision that would have required businesses starting in 2012 to file more 1099 forms to help prevent underreporting of income by vendors. In addition to completing 1099 forms for payment of services rendered by unincorporated providers, as is the case under current law, businesses, charities, and government entities would have also been required to issue the forms for payments above $600 in any year for all types of goods and services, and to all vendors, including to corporations, which were previously exempt. The legislation further repeals a separate provision, under the Small Business Jobs Act of 2010, that mandated similar information reporting by landlords.

The National Federation of Independent Businesses (NFIB), a small business lobbying group, announced it supported the repeal, having argued that the requirement that companies file 1099 forms for all transactions over $600 would have amounted to a burdensome paperwork mandate on businesses.

Despite the relief offered to businesses, concern was raised about the cost of the repeal of the expanded 1099 reporting requirements, estimated at approximately $25 billion over 10 years. Therefore, the new amendment includes a new provision mandating that individuals pay back Federal health care subsidies offered under PPACA if their income increases. These subsidies, which are not available until 2014, are tax credits paid in advance and based on income reported in prior years. Taxpayers who earn more than anticipated, and therefore receive a bigger subsidy than they are entitled to receive, are required to return at least some of that overpayment. The bill increases the amount of excess subsidy that must be repaid by taxpayers who earn more than twice the Federal poverty level, and those earning over four times the Federal poverty level have to pay all of it back.

For more information about the new law, contact one our qualified tax professionals. ■

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the gift at a rate of 100% of their AGI. Any unused deduction remaining after the first year can be carried forward for 15 more years, or until the amount of the deduction has been used up, whichever comes first. These expanded Federal income tax incentives were most recently extended through 2011 by the Taxpayer Relief, Unemployment Reauthorization, and Job Creation Act of 2010. A bill recently introduced in the Senate, the Rural Heritage Conservation Extension Act of 2011, seeks to permanently expand these incentives for donating conservation easements.

The IRS has, however, warned against abuses by some taxpayers of conservation easements, especially façade easements. Appraisals have sometimes been inflated, the easement's restrictions have not been honored, or a façade that was donated had already been protected by local zoning ordinances, and thus did not qualify. In such cases, IRS officials said, deductions on the proposed easements will be disallowed, and excise taxes and penalties will be imposed.

Estate Planning

Donating a conservation easement can also be a useful estate planning tool, reducing the chances that heirs in families that are "land rich but cash poor" may be forced to sell the land to cover the taxes owed. Because the development rights have been extinguished, the value of the land may be lower, thus reducing the potential estate tax liability. Moreover, under Section 2031(c) of the Internal Revenue Code, up to an additional 40% of the value of land (but not of historic property) may be excluded from the estate when the landowner dies. The maximum amount of the exclusion is $500,000. The heirs of a landowner may also take advantage of these benefits, though not of the income tax deduction, by electing to donate a conservation easement after the landowner's death and prior to filing the estate return. This is called a "post mortem" election.

It is important for landowners or their heirs to keep in mind that, while the conservation easement is permanent and irrevocable from the perspective of the owner, the land may still be taken by eminent domain if the government asserts that the public value of the proposed project exceeds that of the conservation interest being protected by the easement. And, while donating an easement can lower income taxes, local property taxes may not be significantly reduced if the land continues to be used for agricultural purposes.

If you are considering a conservation easement, consult one of our qualified tax professionals to help guide you through the process. ■

Tax Breaks for Exporting Businesses

As the economy becomes increasingly globalized, growing numbers of U.S.-based companies are selling their products or services abroad. But, many owners of small and mid-sized businesses may be unaware that the Federal government offers tax incentives to manufacturers and service providers who export their products and expertise.

The technical name for this incentive is the Interest Charge-Domestic International Sales Corporation, or IC-DISC. Currently, around 6,000 U.S.-based businesses take advantage of the IC-DISC incentive, although it is estimated that thousands more who are eligible are failing to do so. This incentive first became available in 1984, but grew in popularity after a reduction in the capital gains tax made it more attractive. The Small Business Jobs Act of 2010 extended the incentive through 2012.

There are several types of companies that can qualify for IC-DISC, including companies that directly export the goods they manufacture. The exporting company must be a flow-through entity, such as an S Corporation or an LLC, or a closely held C corporation. A wide range of products may be exported, including software, films, and agricultural products. Manufacturers of parts that are included in a product that is exported may also qualify for the incentive; some distributors may also qualify. Finally, firms that provide architectural or engineering services that are performed in the United States for buildings, bridges, or other structures that are built in foreign countries may be able to benefit from IC-DISC.

To take advantage of this incentive, companies have to create one or more separate, tax-exempt entities, or an IC-DISC. These are essentially "paper" C corporations, with no employees or tangible assets, that elect to be treated as an IC-DISC and are governed under Sections 991-997 of the Internal Revenue Code.

The exporting company then pays a commission to the IC-DISC, which is generally determined as the greater of 50% of net income from qualified exports or 4% of export gross receipts from qualified exports. The commissions are deductible to the exporter at the ordinary income tax rate of 35%. The IC-DISC returns the commission income to the exporter's shareholders in the form of dividends, which are then taxed at the 15% capital gains rate. This results in a 20% tax savings on the commissions. Thus, the exporter receives a deduction of 35% on the commission payments made to the IC-DISC, while paying a 15% tax rate on the income repatriated from the IC-DISC. The resulting tax savings for the U.S.-based company can amount to 10% or higher of net export income. The tax savings, which can be immediately realized on the exporter's quarterly estimated tax payments, is transparent to the exporter's customers and does not impact the exporter's operations.

In some cases, companies may derive even greater tax benefits by establishing several IC-DISCs for different streams of income, depending on whether the export income from a specific product is low or high margin. The IC-DISC may also be used as an estate planning tool. For example, taxes can be further minimized when children or other family members with a 0% qualified dividend rate are made IC-DISC shareholders.

To fully realize the benefits of the IC-DISC regime, a relatively large volume of international sales is recommended. One of our qualified tax professionals can advise you on whether the IC-DISC strategy makes sense for your business. ■

Made a Mistake on Your 1040? You Can Amend Your Return

Even if you take great care in preparing your Federal tax return, after you have filed it, you may discover that some information is missing or incorrect. Recognizing that mistakes and omissions can occur, the IRS allows taxpayers to amend their returns, and to claim any additional refunds, generally within three years from the date the original return was filed, or within two years from the date the tax was paid, whichever is later.

To correct previously filed Forms 1040, 1040A, or 1040EZ, the IRS allows you to file a Form 1040X, "Amended U.S. Individual Tax Return." If the changes involve another schedule or form, these documents can be attached to the amended return. On the 1040X, you are asked to explain the exact nature of the changes you are making. This amended return cannot be filed electronically, but rather must be sent in paper form by mail to the appropriate IRS Service Center. The IRS manually processes the forms and will notify you if additional information or documentation is needed.

Not every mistake should prompt you to file an amended return. If you discover a math error on your return, you can assume that the IRS will make the correction for you. If you neglected to attach standard forms, like a W-2 or schedules, you can wait for the IRS to request them.

Generally, the IRS expects that any information you provide on your initial tax return is accurate and complete on the day you file, and the IRS is unlikely to hold you responsible for information that did not come to light until after

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NEWS & NOTES

Minimizing the Risk of Getting Audited

The IRS has been stepping up its efforts to ensure that Americans are accurately reporting the taxes they owe and is auditing a growing number of taxpayers.

The percentage of individuals with incomes below $200,000 who were audited has increased only slightly over the last four years, from 0.93% in 2006 to 1.04% in 2010. For taxpayers with incomes over $200,000, however, the percentage rose from 2.57% in 2006 to 3.10% in 2010. Further, among individuals reporting incomes of more than $1 million, the percentage selected for audits jumped from 5.25% in 2006 to 8.36% in 2010.

But, even if your income level increases your chances of receiving an audit notification from the IRS, steering clear of certain "triggers" can help minimize the chances of being selected. In developing a strategy, it is helpful to know how the IRS singles out returns for audits.

Many audit targets are selected through the Discriminate Function (DIF) system. This screening system uses statistical formulas to analyze and score tax returns, identifying the returns that are most likely to have a gap between the taxes owed and the tax liability reported. The system is intended to spot inconsistencies, such as when a taxpayer with a low income claims a large mortgage interest or charitable contribution deduction.

A taxpayer may also be audited if an obvious mismatch exists between the information reported and the amounts that appear on the 1099 and W-2 forms or other income statements. In other cases, individual taxpayers may be singled out for an audit because they are officers or shareholders at a company that is being audited. In addition, wealthy individuals with sophisticated business and financial arrangements, especially those with investments or bank accounts abroad, are being scrutinized more frequently as part of the IRS's Global High Wealth Industry program.

It's important to be aware that claiming certain deductions or credits are especially likely to trigger an audit. These red flags include claiming a home buyer credit, a home office deduction, a deduction for 100% business use of a vehicle, or a large deduction for unreimbursed employee business expenses. The IRS may also scrutinize individuals who have unusual fluctuations in income, earn a substantial amount of their income in cash, claim large Schedule C business losses while earning wages, or have offshore accounts or other foreign income.

Before filing a return, make sure that you have all of the documentation necessary to back up all of the information provided and deductions claimed. ■

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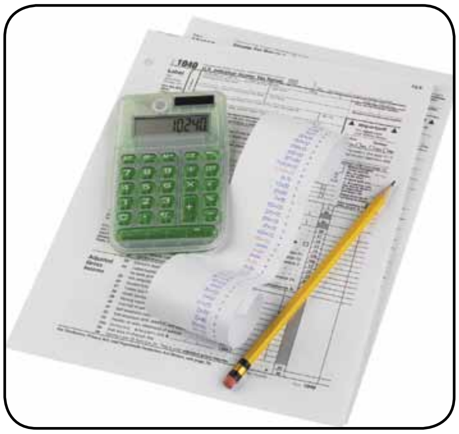
Made a Mistake on Your 1040? You Can Amend Your Return

filing. Nonetheless, you may still wish to amend your return, especially if doing so may reduce your liability, or if you are concerned about being penalized for failing to report income or for claiming deductions or exemptions to which you later discover you were not entitled. Correcting an error or omission before it is found by the IRS can reduce any interest you may owe on underpayment of taxes. For example, you may wish to report a different filing status, change your personal exemptions, add or subtract dependents, report additional income or withholding from 1099 or other income statements, or adjust your deductions or credits.

While you are not required to prepare a revised Form 1040 when filing a Form 1040X, you may want to start from scratch when making any changes to your return, as you may find, for example, that an adjustment in your income also alters your eligibility for certain deductions and credits based on income thresholds.



If you are filing to claim an additional refund, wait until you have received your original refund before sending in Form 1040X. You are permitted to cash the first refund check while waiting for any additional refund. If, however, you owe additional taxes, or need to return a portion of a refund, be sure to file Form 1040X as quickly as possible and pay the tax before the due date to limit interest and penalty charges that may otherwise accrue.

If you amend your Federal return, keep in mind that your state tax liability may also be affected. Contact your state tax agency for advice on whether and how you need to amend your state return. Because amending a return, even to correct a minor oversight, could bring additional scrutiny from the IRS, be sure to seek advice from one of our qualified tax professionals before filing a 1040X. ■