

TAXOLUTIONS



►► *ideas on taxes*

ROTH IRA CONVERSIONS AVAILABLE FOR HIGHER INCOME TAXPAYERS

Starting in 2010, the \$100,000 adjusted gross income (AGI) ceiling on converting traditional IRAs to Roth IRAs has been eliminated. For higher income taxpayers, this opportunity to convert can provide tax savings.

Under the Tax Increase Prevention and Reconciliation Act (TIPRA), passed in May 2006, all taxpayers, regardless of income level, can convert traditional IRAs to Roth IRAs any time after December 31, 2009. Under a special provision of TIPRA, a taxpayer who converts in 2010 may choose to either pay the entire tax owed on the converted funds in the current year or spread the payment over 2011 and 2012. Income inclusion will be accelerated if distributions are taken during these years, and taxpayers should keep in mind that, under current law, tax rates are scheduled to increase in 2011 with the sunset of 2001 tax reform.

Funded with after-tax dollars, Roth IRAs offer tax-free earnings and tax-free distributions. Because contributions to traditional IRAs may qualify for a tax deduction, any tax-deductible savings transferred from IRAs to Roth IRAs are taxed immediately. If nondeductible IRAs are converted to Roth IRAs, taxes are owed on accumulated earnings, but not on the principal. While

contributions to a traditional IRA are not permitted over age 70½, there are no age restrictions on contributions to a Roth IRA.

For taxpayers who expect to be in a comparable or higher tax bracket during retirement, the Roth IRA may offer advantages. Unlike traditional IRAs, Roth IRAs have no minimum distribution requirements at age 70½. This makes the Roth IRA particularly attractive to individuals who wish to pass on their tax-free savings to heirs, rather than draw down the funds to finance their retirement. Bear in mind that there may be estate tax implications. In addition, converting to a Roth IRA allows taxpayers to lock in a tax rate, whereas those with traditional IRAs will

be unable to predict changes in the law or their own circumstances that could push them into a higher tax bracket in retirement.

Some restrictions do apply to Roth IRAs. Qualified distributions, including earnings, are tax free provided the account holder has reached age 59½ and has owned the account for five years. Withdrawals made prior to age 59½ may be subject to a 10% Federal income tax penalty. Certain qualified exceptions apply.

This rule change provides an opportunity for more taxpayers to take advantage of the Roth IRA. For specific guidance, consult one of our qualified tax professionals. ■

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CHARITABLE GIVING YIELDS TAX BENEFITS FOR BUSINESSES

An economic downturn may not seem like the best time to increase charitable giving, but at the same time, the need for funding at many nonprofits is especially acute as a result of the current economy. In addition to supporting a worthy cause, you or your business can help lower your tax bill through cash donations, as well as contributions in the form of unused inventory or sponsorship.

Choosing an Organization

When it comes to tax deductions for charitable giving, the rules are complicated. As you begin to formulate a giving strategy, be sure that the organizations you intend to support have been awarded tax-exempt status by the Federal government. In addition to not-for-profit organizations engaged in charitable activities, qualified groups include nonprofit schools and hospitals, most churches and religious organizations, veterans' groups, and public parks and recreational facilities.

If you are not sure if a group you are interested in supporting is qualified to receive deductible contributions, you can search for the name of the organization on the IRS website at www.irs.gov/app/pub-78. Businesses may also make donations through exchanges that connect donors with qualified nonprofit organizations and provide the necessary documentation for tax deductions.

Overall Limitations

There are other things to keep in mind when developing a giving strategy. To start, the IRS does not view all charitable contributions as tax deductible, and different rules apply depending on the legal status of the business. Contributions by C corporations are limited to 10% of the business's taxable income. Sole proprietors, partners, and S corporation owners cannot take a business deduction for charitable contributions. Instead, gifts

by these entities are considered personal charitable contributions and are treated accordingly for tax purposes.

For personal deductions, the amount may be limited depending on the type of property donated and the organization receiving the gift. Deductions of cash may not exceed 50% of adjusted gross income (AGI) for gifts to public charities and 30% of AGI for gifts to private foundations. For both long- and short-term appreciated property, the deduction is limited to 30% of AGI for gifts to public charities and 20% of AGI for gifts to private foundations.

Excess Inventory or Overstock

Many businesses donate excess inventory or overstock to charities. When individuals choose to contribute tangible property in the form of merchandise or other assets, they are generally permitted to deduct the amount of the property's fair market value, or the price a buyer would be willing to pay for the item on the open market. However, specific rules apply to donations of business inventory.

C corporations are allowed to deduct the cost of producing the donated goods, plus half the difference between that cost and the fair market value of the goods, up to two times the production cost. Meanwhile, owners of S corporations, partnerships, and sole proprietorships may only deduct the cost of producing the inventory.

Other restrictions apply to food inventory. The foodstuffs donated must go to help infants or needy or infirm individuals, and the food must be needed for the charity's exempt purpose or function.

Documentation Requirements

Regardless of whether you are donating cash or property, request a written acknowledgement from the charity for gifts in excess of \$250. This may, for example, take the form of a canceled

check or a contribution statement from the charity, and it must indicate the amount of cash received or a description of the property given, as well as the value of any goods or services provided by the charity in exchange for the donation.

If you or your company receives something in return for a charitable gift, such as tickets to a benefit event or an item from a charity auction, you are only permitted to deduct the amount of your contribution that exceeds the fair market value of the benefit received.

Other Charitable Endeavors

In addition to claiming tax deductions for charitable gifts, your company could choose to support a charity through sponsorship or cause-related marketing, in which a portion of the proceeds of sales go to the charity. While these initiatives do not qualify for charitable tax deductions, they can be claimed as marketing expenses. You and your employees are not allowed to deduct the time spent or the value of the services provided when volunteering for qualified charities, but you are permitted to deduct certain out-of-pocket expenses incurred in the course of voluntary activities, such as mileage.

If your business is contemplating larger donations or a series of donations over time, you may wish to establish a charitable trust or philanthropic foundation to manage the company's charitable giving. Contact your legal advisors for more information.

Charitable donations, whether made by a business or its owner, are important to the mission of worthy nonprofits. They can also help generate positive publicity, boost a company's visibility in the community, and improve the morale of workers, all while providing a tax deduction for the owner or the business. If you are considering a charitable giving strategy, contact one of our qualified tax professionals. ■

NEW SPLIT-REFUND OPTION AVAILABLE IN 2010

Starting in 2010, taxpayers have a new split-refund option for Federal tax refunds that allows them to purchase Series I U.S. Savings Bonds issued by the U.S. Department of the Treasury.

With the split-refund option, taxpayers may designate up to three financial accounts into which a refund will be deposited. For example, a taxpayer might designate that part of the refund be deposited into a savings account, part into a checking account, and part into a retirement fund. Other examples of eligible financial accounts include health savings accounts and Coverdell education savings accounts.

Starting in 2010, taxpayers may also use the split-refund option to purchase savings bonds. Under the new program, taxpayers may purchase up to \$5,000 of Series I bonds per year, in denominations starting at \$50. If all of the refund is not used to buy bonds, the taxpayer must specify a bank account to deposit the remainder of the refund. For example,

if a taxpayer's refund is \$792, he can specify on his tax return that he wishes to direct \$750 to buying bonds and the remaining \$42 to a savings account.

Bonds purchased through the new split-refund option will be issued in the taxpayer's name, and the certificates will be sent to the address on the tax return. If the taxpayer is married and files a joint return, the bonds will be issued in both spouses' names. Taxpayers are not permitted to name a beneficiary, such as a child or a grandchild, when using this option.

Series I bonds pay interest based on a combination of a fixed interest rate, which remains the same throughout the life of the savings bond, and a semiannual inflation rate, which is updated at six-month intervals each May and November. As of January 2010, the fixed interest rate was .30%, and the semiannual inflation rate was 3.06%. While the interest earned by purchasing and holding savings bonds is subject to Federal

tax at the time the bonds are redeemed, the interest is not taxable at the state or local level.

Series I bonds may not be an appropriate choice for taxpayers who expect to cash them in within five years or less. In general, Series I bonds may not be redeemed in the 12 months following purchase, except under certain circumstances. If bonds are redeemed within five years of the initial purchase, the owner will forfeit the interest accrued in the three most recent months. No penalties apply if bonds are redeemed after five years.

According to the IRS, taxpayers who choose this option can expect to receive the bonds in the mail after the remainder of the tax refund is deposited into their bank account. Additional processing and delivery may take up to three weeks.

For more information, consult one of our qualified tax professionals. ■

LTC HYBRIDS: A NEW OPTION

When most people hear the word "hybrid," they think of combination gasoline and electric vehicles. Using hybrid technology, the auto industry developed a self-sustaining and energy-efficient vehicle that optimizes fuel use and mileage. In response, the Federal government provided tax incentives to individuals who purchased these fuel-efficient vehicles.

Interestingly, hybrids, or combinations, can work in other areas, including your insurance coverage. Due to a provision of the Pension Protection Act of 2006 (PPA) that went into effect on January 1, 2010, individuals are now allowed to transfer values that have accumulated in existing life insurance policies or annuities into a "hybrid" or combination insurance policy that includes a long-term care (LTC) benefit—without incurring tax consequences. LTC insurance can help protect your assets

and provide increased options for care should you one day require assistance due to a reduced level of functioning resulting from illness, injury, or aging.

While annuities offer tax-deferred growth, earnings on the income provided by annuities are subject to taxation. Life insurance policy benefits are also subject to taxation. Benefit payments made by qualified LTC insurance policies, on the other hand, are generally tax free. Although products that combine a nonqualified annuity or life insurance policy with a qualified LTC insurance rider were available prior to the passage of the PPA, the tax treatment of these combination products had not been fully clarified.

Beginning this year, you may purchase combination policies—or exchange existing policies for combination products—that cover a specified amount of

qualified LTC expenses, based on an actuarial assessment of your potential LTC needs. For example, you could purchase an annuity that offers LTC coverage under a rider. Should the need for LTC arise, your insurance provider would accelerate your benefits, paying for your LTC expenses tax free using the principal and any earnings that had accumulated in the annuity, while still providing insurance payments up to the specified amount. If you never use your LTC rider, the funds in the annuity, plus earnings, remain secure until they are paid out as income or are withdrawn by you or your beneficiaries, with the earnings subject to taxation.

One advantage of a combination annuity or life insurance policy with an LTC rider is that premium payments are not lost if the coverage is not used. However, there is generally a cap on the

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amount of coverage provided for LTC. Yet, because of this cap, LTC coverage obtained through a hybrid policy is generally less expensive, and underwriting requirements may be less stringent, which may result in a less expensive hybrid option for older individuals or those with health problems.

If you currently have an annuity or life insurance policy and are interested in a hybrid product with LTC coverage, the PPA allows you to use a tax-free 1035 exchange to replace the policy you currently have with a new life insurance or annuity hybrid policy with an LTC insurance rider. Through other options under the PPA, you could upgrade your current policy by adding an LTC insurance rider, or you could do a partial 1035 exchange and use the proceeds to purchase a standalone LTC insurance policy.

Prior to the PPA, the cost of adding an LTC rider to an annuity was treated as a charge against the cash value of the contract and considered part of the annuity owner's income. Starting in 2010, the cost of the LTC rider is not treated as income, but instead reduces the basis of the annuity. Although the 1035 exchange is tax free, surrender charges may apply, and life insurance policies could lapse in some cases.

Under certain circumstances, standalone LTC insurance policies, which may offer higher levels of coverage, may be more appropriate than combination products. For example, if you do not already have a nonqualified annuity or life insurance policy, and do not wish to invest a large lump sum, a standalone policy that allows you to spread out your premium payments may be preferable.

Also, the tax deduction permitted for standalone, qualified LTC insurance policies may not be taken in conjunction with combination products. Premiums for qualified LTC policies can be deducted as a medical expense, subject to the 7.5% of adjusted gross income (AGI) floor. In 2010, the qualified deduction for LTC insurance premiums is limited to \$330 for those age 40 and under, \$620 for those age 41 to 50, \$1,230 for those age 51 to 60, \$3,290 for those age 61 to 70, and \$4,110 for those over age 70.

If you have been thinking about future long-term care needs, a hybrid option for tax-free LTC benefits may allow you to "get more mileage" out of your existing life insurance policy or annuity. For more information, contact one of our qualified tax professionals. ■