

TAXOLUTIONS



►► *ideas on taxes*

YEAR-END PENSION LEGISLATION PROVIDES RELIEF

On December 23rd, President Bush approved new legislation providing limited relief from minimum distribution and pension funding requirements. The new law, the Worker, Retiree, and Employer Recovery Act of 2008, was enacted to alleviate some of the adverse effects the recent financial downturn has had on retirement plans and retirement plan participants.

Relief from 2009 Required Minimum Distributions

If you own a retirement plan account, such as a 401(k) or Individual Retirement Account (IRA), the IRS mandates that you take annual **required minimum distributions (RMDs)** upon attaining age 70½. If you fail to withdraw at least the minimum amount, the IRS may impose a 50% penalty each year on the dollar amount that you failed to withdraw. Minimum required distributions are calculated according to the value of the account as of the last day of the previous year and the age of the participant or beneficiary.

As a result of the recent economic downturn, many plan asset values have declined significantly in the last year. Recognizing that many participants and beneficiaries will be required to take minimum distributions from plans and IRAs with significantly reduced assets,

the Worker, Retiree, and Employer Recovery Act of 2008 waives the rules concerning RMDs for the 2009 year only.

First-time Distributions

Those who turn 70½ in a given year are permitted to postpone their first distribution until April 1st of the year following attainment of age 70½. The second RMD would also be due in the year following attainment of age 70½. It is important to note that the new law waives 2009 RMDs only; it does not waive any 2008 RMDs that an owner chooses to postpone until April 1, 2009. If an account owner fails to take the 2008 RMD by April 1, 2009, he or she may have to pay the penalty tax on any RMD amount not taken. The second distribution (the 2009 RMD) may be waived according to the new law.

An account owner who turns 70½ in 2009 would have been required, in the absence of the 2009 RMD waiver, to take the first RMD (the 2009 RMD) by April 1, 2010 and then take the 2010 RMD (the second RMD) by December 31, 2010. The new law waives the first RMD (the 2009 RMD) for account owners who turn 70½ in 2009. However, the waiver does not affect RMDs required for 2010. The account owner would still be required to take the second RMD by December 31, 2010.

Pension-related Provisions

The Worker, Retiree, and Employer Recovery Act of 2008 also provides relief to defined benefit plans struggling to meet funding requirements and includes

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TaxGuideOnline
www.lcszcpa.com

LCS&Z, L.L.P.
Certified Public Accountants
and Consultants

William Lutz, CPA
Thomas F. Cichy, CPA
Edward J. Selig, CPA
William A. Zeronda, CPA
Ralph M. DiVietro, CPA
Richard J. Anastasia, CPA
Gregory J. Abbattisti, CPA



33 Century Hill Drive
Latham, New York 12110
(518) 783-7200
Fax (518) 783-7385
E-mail: lcsz@lcszcpa.com

420 Lexington Avenue
Suite 300
New York, New York 10170
(212)207-6204
E-mail: lcsz@lcszcpa.com

33 Bleecker Street
Gloversville, NY 12078-2909
(518) 773-2267
Fax (518) 773-2273
E-mail: lcsz@lcszcpa.com

MAXIMIZING HEALTH INSURANCE TAX DEDUCTIONS

Individuals and business owners alike are concerned about the already high, and rapidly rising, cost of health insurance. But whether you are an employee, an employer, or a self-employed individual, there are a range of Federal tax deductions available to you, including breaks provided by Health Savings Accounts (HSAs) and similar tax-advantaged accounts.

For Individuals

If you are an employee with access to group health care coverage, you do not pay taxes on the contributions you make to your health insurance premiums. But what are your options if your company does not provide medical benefits or if you own a business?

A savings account that must be paired with a qualified high-deductible health plan (HDHP), HSAs allow individuals to save money tax free, and the employers of account holders can make tax-free contributions to workers' accounts. Provided the funds are used to pay for out-of-pocket health care expenses, the money deposited in an HSA is never subject to Federal income tax. HSA contributions may be invested in a manner similar to retirement accounts, and investment earnings and interest accrue tax free. These accounts can be especially attractive for higher income individuals, as any funds not spent in a given year can be carried over indefinitely, and they may even be withdrawn penalty free in retirement for non-qualified expenses.

Because they are used in conjunction with HDHPs, the cost of insurance premiums for HSA policies can be much lower than for comprehensive health plans. In 2009, an HSA-qualified plan must have a deductible of \$1,150 or more for an individual and \$2,300 or more for a family. The 2009 out-of-pocket maximum, which includes the deductible and any potential co-insurance payments, is \$5,800 for an individual and \$11,600 for a family.

The statutory contribution limits for HSAs are set each year by the Internal Revenue Service (IRS). The limits for 2009 are \$3,000 for an individual plan and \$5,950 for a family plan. HSA holders age 55 and older may, however, make annual catch-up contributions of \$1,000. These annual contribution limits apply regardless of whether the deposits are made by the account holder or by his or her employer. HSAs are always owned and administered by individuals, and account holders may keep any funds contributed to their HSAs, even if they change jobs.



HSA funds, which are usually accessed through a debit card or checks supplied by the health insurance provider, may be used to pay for a wide range of health care expenses, including doctors' visits, hospital stays, medical tests, dental care, prescriptions, over-the-counter drugs, medical equipment, and even long-term care insurance premiums. Withdrawals that are not made for qualified medical expenses are, however, subject to income taxes and, for those under the age of 65, a 10% penalty. Any funds remaining in an HSA at the time of the account holder's death may be passed on to a spouse tax free or to another designated beneficiary, who must pay taxes on distributions.

For the Self-Employed

Whatever type of health coverage you select, you may be able to deduct your health insurance premium payments if you are self-employed. Provided you had

a net profit for the year, you are generally entitled to deduct, as an adjustment to income, up to 100% of the amount paid for medical and qualified long-term care insurance on behalf of yourself, your spouse, and your dependents.

Under IRS rules, the insurance plan must be established under your trade or business, and the deduction may not exceed your earned income from that trade or business. You are not permitted to claim this deduction for any month in which you were eligible to participate in any subsidized health plan maintained by another employer, such as your spouse's employer.

For Business Owners

If you are a business owner and wish to provide health care benefits to employees, you have a number of choices, including an HSA option coupled with a high-deductible plan or a number of group plans that feature more traditional forms of coverage, such as health maintenance organizations (HMOs) or preferred provider organizations (PPOs). If you would like to offer employees a consumer-driven health plan similar to the HSA, but would like to maintain greater control over the funds contributed to employee accounts, you may wish to consider a Health Reimbursement Arrangement (HRA).

Regardless of the type of business you operate, you can always deduct 100% of the premiums paid on behalf of your employees. If the business is incorporated, all costs for your own insurance, as well as for your employees, are deductible.

The high cost of health insurance can have a profound effect on both individuals and business owners. While certainly not a solution to rising costs, be sure to maximize your tax advantages and deductions to help keep more of your hard-earned money in your own pocket. To learn more, contact one of our qualified tax professionals. ■

KEEPING TAXES LOW WHEN MAKING LOANS TO FAMILY MEMBERS

While small interest-free loans may be common in your family, you should be aware that all larger transfers of money between adult family members can have tax consequences. Yet, when structured properly, intra-family loans can serve as a means of passing on wealth to the next generation, while keeping interest payments within the family and minimizing income taxes.

There are many reasons why you may wish to loan larger sums of money to adult children or other family members, including providing them with capital to start a business, buy a home, make an investment, or pay off personal debts. But if the amount loaned is substantial, generally more than \$10,000, an enforceable promissory note stating the terms of the loan should be drafted. This document usually includes information about the loan amount, repayment dates, the rate of interest, and any collateral or security provided by the borrower. In the absence of a valid note, the Internal Revenue Service (IRS) could classify the transaction as a gift that may be taxed accordingly.

While it is not always necessary to seek legal help in drafting a promissory note between family members, you may want to consider securing the note with the property if the loan is being used toward the purchase of a home. Failure to report a loan on a mortgage application could have legal consequences. Therefore, it makes sense to consult a lawyer when drafting these types of loan agreements. You should also be aware that, while the IRS usually ignores intra-family loans of under \$10,000, special rules apply if the funds are used to purchase income-producing assets.

If you are the lender, you are required to declare the interest income on loans exceeding \$10,000 that are not paid back within the year on your income tax return. If you fail to charge interest or do not charge interest above a certain

rate, the IRS could classify the transaction as a taxable gift or tax you on the interest you would have received from the loan based on what the IRS considers to be a minimum interest rate. To provide guidance to lenders and borrowers, the IRS has established minimum interest rates for loans between family members. These so-called Applicable Federal Rates (AFRs) vary according to the length of the loan and the current yield on Treasury securities. AFRs are updated monthly on the IRS website.

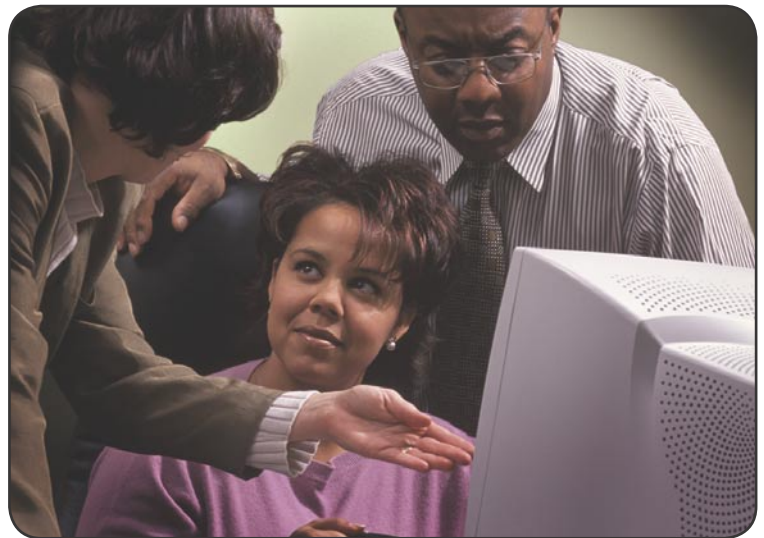
If the loan amount is \$100,000 or less and the borrower does not have net investment income exceeding \$1,000 for the year, the transaction is generally exempt from these so-called “imputed interest” rules. But if, for example, the borrower has investment earnings amounting to \$1,500, while the imputed interest on the loan based on the AFR is \$2,000, the lender will only be required to report \$1,500, or the total amount of the borrower’s investment earnings for the year, as interest income. The lender may also choose to forgive a portion of the loan each year up to the amount of the gift tax exclusion, which is \$13,000 per gift made by an individual and \$26,000 per gift made jointly by husband and wife in 2009.

If your relative fails to repay the loan, you may be able to write off the default as a short-term capital loss on your taxes. To claim this deduction, you must demonstrate that you have made a written request for repayment from your family member. Keep in mind,

however, that the IRS may then assume that the debt has been forgiven and attempt to collect additional taxes from your relative.

From the perspective of the borrower, the tax implications of a loan from a family member will vary according to the purpose of the loan. The interest paid on a loan used to cover personal debts is not deductible, but interest payments on a loan used for business purposes may be classified as a deductible business expense. Provided the property is secured by a note through a mortgage or trust deed, the borrower may be able to deduct interest payments on the loan as mortgage interest. If the money borrowed is invested, the interest will be subject to investment interest rules.

Whatever the nature of your personal relationship with a family member to whom you are lending money, it is important to remember that proper documentation and careful consideration of the tax and legal consequences of the loan can help to protect the interests



of both parties and preserve good will between you. Before lending significant sums, always consult your attorney and tax professional. ■

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long-awaited corrections to the Pension Protection Act of 2006 (PPA). Among them are the following:

- Defined benefit retirement plans that fall below the targeted funding percentages set up by the PPA (92% for 2008, 94% for 2009, and 96% for 2010) may make subsequent contributions up to the specified funding percentage for that year, rather than 100%, as had been required under the PPA.
- Plans can smooth unexpected gains and losses in assets over a two-year period to determine funding levels.
- Plans that are less than 60% funded in the current year may use their adjusted funding target attainment percentage (AFTAP) from the previ-

ous year to determine their funding status. They may also make accelerated benefit distributions in the form of lump-sum distribution payments of \$5,000 or less.

- Multi-employer plans may elect to freeze their current funding certification based on the previous year's status.
- The funding improvement and rehabilitation period has been extended by three years for plans in the critical or endangered status, from 10 to 13 years, and for plans in the seriously endangered status, from 15 to 18 years.
- For plans with 500 or more participants, the threshold used to identify at-risk plans, to which the PPA

imposes additional funding requirements, has been extended to help some plans avoid at-risk status.

- For small plans with 100 or fewer employees that have an alternate valuation date for the determination of contributions and restrictions, the Treasury and the IRS are authorized to establish special rules.
- All qualified plans are required to permit rollovers out of the plan for non-spouse beneficiaries starting in 2010. It is important to note that, under current law, there is no non-spouse rollover available from IRAs.

For more information about the new law and how it may affect your retirement savings, give us a call. ■

LCS&Z, L.L.P.
Certified Public Accountants
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www.lcszcpa.com

William Lutz, CPA
Thomas F. Cichy, CPA
Edward J. Selig, CPA
William A. Zeronda, CPA
Ralph M. DiVietro, CPA
Richard J. Anastasia, CPA
Gregory J. Abbattisti, CPA



33 Century Hill Drive
Latham, New York 12110
(518) 783-7200
Fax (518) 783-7385
E-mail: lcsz@lcszcpa.com

420 Lexington Avenue
Suite 300
New York, New York 10170
(212)207-6204
E-mail: lcsz@lcszcpa.com

33 Bleecker Street
Gloversville, NY 12078-2909
(518) 773-2267
Fax (518) 773-2273
E-mail: lcsz@lcszcpa.com