

# CPA Client Bulletin

Smart Tax, Business & Planning Ideas from your Trusted Business Advisor<sup>SM</sup>

## Tax Breaks for Business Driving

March 2010



The IRS has announced optional standard mileage rates for tax deductions in 2010. The rates are 50 cents per mile for business driving, 16.5 cents per mile for medical or moving, and 14 cents per mile for charitable volunteer work.

**Example:** Elly Morgan drives her own car 7,000 miles for business in 2010. She also drives 500 miles for medical purposes, such as driving to doctors' appointments. In addition, Elly drives a total of 600 miles to a local charity where she volunteers.

Elly may be able to deduct \$3,500 for business mileage: 50 cents times 7,000 miles. She also may be able to deduct \$82.50 for her medical miles (500 times 16.5 cents) and \$84 for her charitable driving (600 times 14 cents).

### For the record

Taxpayers such as Elly who drive a car for business purposes have two ways to support their deductions in case of an IRS challenge. The first is the actual expense method. With this technique, you must tally all of your car-related expenses for the year. They include gas, oil, repairs, tires, insurance, registration fees, licenses, and depreciation (or lease payments).

You also must keep a log to determine how much of that driving is related to business. (Driving to and from work doesn't count as business mileage.) If Elly's log shows that she drives her car 10,000 miles a year, including 7,000 business

miles, then 70% of all of her auto-related costs are tax deductible.

The second way to support a deduction for business driving is the standard mileage rate method described previously. Many people prefer this method because they don't have to do as much record keeping. All Elly needs to do is log the total number of business miles she drives, then multiply that number by the standard rate, which is 50 cents per mile in 2010.

With either method, you can add business-related tolls and parking to your deductible expenses for the year.

If you don't mind keeping extensive records of your auto expenses, you might find that the actual expense method provides a larger tax deduction than the standard mileage rate method. However, you may not be allowed to choose between methods in a given year.

**For a car that you own**, you can use the standard mileage rate method only if you use it the first year the car is available for business use. Then you can use either method in subsequent years.

**For a car that you lease**, you can use the standard mileage rate method only if you use it for the entire time you lease the car.

### Deduction requirements

You will find it relatively easy to deduct business driving expenses if you report business income on Schedule C of your tax return as a sole proprietor. That Schedule has a line for car and truck expenses.

If you are an employee, you will have to clear some hurdles to deduct any driving costs. You can deduct only unreimbursed

## What's Inside

- 1 Tax Breaks for Business Driving
- 2 Tap Your IRA, Avoid the Early Withdrawal Penalty
- 3 Take a New Look at Your Old Life Insurance Policy
- 4 Tax Calendar



America Counts on CPAs

## Fast Fact

*In mid-November 2008, the price of gold was just over \$700 an ounce.*

*During the following 12 months the price of gold rose about 60%, to \$1,140 an ounce.*

*Source: [goldprice.org](http://goldprice.org)*

*continued on page 2*

continued from page 1

employee business expenses. Therefore, if your employer fully reimburses you for your business driving, you can't take any deduction. If your employer provides partial or no reimbursement, you can report your unreimbursed driving expenses as a miscellaneous itemized deduction. (If your employer reimburses employees

at a rate higher than the 2010 standard mileage rate, the excess over 50¢ per mile will be additional income to you, subject to income and payroll taxes.)

Other miscellaneous deductions include investment-related expenses and tax preparation fees. If the total of your miscellaneous deductions exceeds 2% of your adjusted gross income,

the excess is tax deductible. However, you can't take any miscellaneous deductions (including unreimbursed employee driving expenses) if you owe the alternative minimum tax.

You should also keep a log to substantiate deductions for qualified medical, moving, and volunteer driving. ■

## Tap Your IRA, Avoid the Early Withdrawal Penalty

When you withdraw money from your traditional IRA, you probably will owe income tax. Moreover, the R in IRA stands for *retirement*, so the tax code discourages early withdrawals. You probably will owe a 10% penalty tax if you take money from your IRA before age 59½. This surtax can be especially painful for individuals facing financial difficulties.

**Example 1:** Matt Peters was laid off from his publishing job at age 52. He is working as a freelance editor this year, but his income is sharply lower than it had been. Matt takes \$10,000 from his IRA to help pay his bills.

This year, Matt's income will put him in the 15% tax bracket. Therefore, he owes \$1,500 in federal income tax on his IRA withdrawal: 15% of \$10,000. Matt also owes a 10% surtax of \$1,000 (10% of \$10,000) because he is under age 59½. As you can see, the early withdrawal penalty increases his tax obligation sharply, from \$1,500 to \$2,500.

### 10% Solutions

Fortunately, the tax code includes several exceptions to this 10% penalty. They include:

- ✓ **Death.** You won't owe a penalty if you are the beneficiary of an IRA after the IRA owner's death.
- ✓ **Disability.** You can take penalty-free distributions from your IRA if you are disabled.
- ✓ **College costs.** You can withdraw an amount equal to or less than what you pay for higher education expenses in a calendar year.



- ✓ **Home acquisition costs.** You can use the distributions to buy, build, or rebuild a home.
- ✓ **Medical insurance.** If you lose a job and collect unemployment insurance for at least 12 consecutive weeks, you can tap your IRA for an amount up to your costs for health insurance.
- ✓ **Medical expenses.** If you have unreimbursed medical expenses that are more than 7.5% of your adjusted gross income, you can withdraw the excess amount from your IRA.
- ✓ **Annuity payouts.** Distributions avoid penalties if they are taken as a series of substantially equal periodic payments (SOSEPP).

### The two-year hitch

Some of these exceptions come with fine print. For the home acquisition exception, the home buyer can be the IRA owner, the IRA owner's spouse, either spouse's ancestor, or either spouse's descendant. You can take money from your IRA to provide your son with a down payment on a home, for example, and avoid the 10% surtax.

In addition, every home buyer must be a "first-time" buyer. That is, he or she cannot have owned a principal residence in the two years prior to the purchase. If the buyer is married, both spouses must pass this two-year test.

Finally, this exception to the 10% penalty is limited to \$10,000. That \$10,000 is a lifetime amount, per taxpayer. Thus, a married couple can each withdraw up to \$10,000, penalty free, to finance a home purchase if all the other requirements are met.

### Doubts about disability

In some recent Tax Court cases, the IRS prevailed over taxpayers who had claimed the penalty exception for disability. The taxpayers had suffered a mental or physical condition that caused them to leave their jobs. By the time the cases came to court, those taxpayers had returned to work, full time. The Tax Court ruled that they were not disabled for the purpose of the exception to the 10% early withdrawal penalty.

The issue apparently has become an area of concern to the IRS, which issued a Chief Counsel Advice (CCA) on this subject last year. (A CCA is a notice of instruction from IRS lawyers to the agency's employees.) According to this CCA, in order to qualify for the disability exception, a taxpayer must not be able to work in a suitable job. What's more, the medical condition must be serious enough that it likely will keep the individual out of work for several years or even longer.

## Precise payouts

Many taxpayers use a series of substantially equal periodic payments (SOSEPP) to take money from an IRA penalty free before age 59<sup>1/2</sup>. A SOSEPP can be used by any taxpayer, so you don't have to fit into a particular situation (disabled, first-time home buyer, and so forth) to qualify. There are several ways to calculate a SOSEPP, which means that you have a great deal of flexibility in determining how much you want to take from your IRA. Our office can help with the calculation.

On the other hand, once you begin a SOSEPP you must maintain it for at least five years or until age 59<sup>1/2</sup>, whichever comes later. If you withdraw more or less than the required amount, you will owe the 10% penalty on all your withdrawals before age 59<sup>1/2</sup>.

**Example 2:** Lois Franklin starts a SOSEPP at age 52. Her CPA determines that Lois can withdraw \$10,000 a year, penalty free. After three years of \$10,000 withdrawals, Lois has a financial emergency and must tap her IRA for \$25,000. She will owe the 10% penalty on all \$55,000 of premature withdrawals.

Alternatively, suppose Lois gets a high paying job at age 55, after

taking \$30,000 worth of SOSEPP withdrawals. She does not need to take IRA withdrawals any longer; in fact, Lois would like to stop draining her retirement fund. However, Lois must maintain her SOSEPP until age 59<sup>1/2</sup> in order to avoid owing a 10% penalty on her SOSEPP withdrawals so far.

In addition, today's low interest rates make taking a SOSEPP relatively unattractive now. With a \$250,000 IRA, for example, a 52 year old could take less than \$13,000 a year, penalty free.

## The more the merrier

Now for the good news: a Tax Court case in 2009 indicated that you can use more than one exception to increase penalty-free IRA withdrawals. In this case (*Benz v. Commissioner*), the taxpayer was taking a SOSEPP. One year, she took out the SOSEPP amount and also withdrew \$22,500 to pay college costs for her son. She did not pay any penalty on these withdrawals.

The IRS allowed penalty-free withdrawals for her college costs, under the exception for higher education expenses, but the IRS also said that taking out the extra money for college spoiled her series of substantially equal periodic payments. Therefore, the IRS

assessed a 10% penalty for some of her IRA withdrawals.

The Tax Court decided in favor of the taxpayer, ruling that her penalty-free withdrawal for college costs did not interfere with her scheduled SOSEPP. Therefore, it appears that you are allowed to use more than one exception to the 10% penalty for early IRA withdrawals. ■

## Trusted Advice

- ❖ From age of 59<sup>1/2</sup> to 70<sup>1/2</sup>, you have a great deal of flexibility with your traditional IRA.
- ❖ You are beyond the 10% early withdrawal penalty, which expires at 59<sup>1/2</sup>. Yet you are not required to take minimum withdrawals until 70<sup>1/2</sup>.
- ❖ One strategy is to take enough withdrawals to fill up a tax bracket.
- ❖ In 2010, the 15% tax bracket for married couples goes up to \$68,300 of taxable income. If you are 60 years old with joint taxable income of \$65,000 this year, you can pull \$3,300 from your IRA and owe only \$495 (15%) to the IRS.

# Take a New Look at Your Old Life Insurance Policy

If you have a permanent life insurance policy, it's time for a current review. You may have to increase your premiums or cut your coverage in order to maintain the policy.

Permanent life insurance includes whole life, universal life, and variable life insurance. All charge higher premiums than term life insurance.

You pay the excess premiums in order to fund a "cash value" account within the policy. As you grow older and the actuarial cost of insuring your life increases, the insurance company will tap the cash value to pay some

or all of the premiums. Thus, these policies are "permanent": they are designed to remain in effect as long as you live.

## Cash value crunch

When you buy a permanent life insurance policy, your insurance agent probably will supply you with an "illustration." The illustration is actually a projection of how your cash value will grow over the years.

**Example:** George Hane buys a permanent life insurance policy that calls for him to pay \$100,000 in premiums over 10 years. The illustration might

show the cash value at \$200,000 after 20 years. Then, as the life insurance cost for George climbs, the projected cash value will decline.

With a variable life insurance policy you can direct how your premiums will be invested. Many policyholders invest largely in stock funds, so their projections are based on historic stock market returns. Universal life and whole life policy illustrations tend to assume that cash value will grow at rates comparable to bond yields.

Unfortunately, many of those illustrations turned out to have been overly optimistic. Stocks have gone

*continued on page 4*

continued from page 3

nowhere in recent years, on average, so many variable life policies have cash values that are far below illustrated value. Universal life and whole life policies also lag their projections, in many cases, because bond yields have fallen below the levels that were



forecast when the insured purchased the policy.

Therefore, the George of our example might not have \$200,000 in cash value after 20 years. He might have \$180,000,

\$150,000, or even less. His policy may be inadequately funded considering the amounts needed to pay insurance premiums for the rest of his life.

### Paying the price

If you have such a policy, your first step should be to ask your agent for an "in-force ledger." This report will show the current level of cash value in your policy and whether it's sufficient to maintain the policy. In many cases, you'll find that you'll need to pay higher premiums (or resume paying premiums you've stopped paying) in order to keep the policy in force.

Another option might be to maintain your current premium

schedule but settle for a smaller death benefit. Such a decision could be prudent if your need for life insurance has been reduced; for example, now that your children are finished with their education and living independently.

Yet another option is to exchange your existing policy for a new one with stronger guarantees of cash value and death benefits. You can execute such an exchange tax free under Section 1035 of the tax code. Our office can help you analyze an in-force ledger of your existing policy and work with your life insurance professional to make sure you thoroughly understand your options. ■

## TAX CALENDAR

### MARCH 2010

#### March 1

**Employers.** File Form W-3, along with Copy A of all the Forms W-2 you issued for 2009. If you file Forms W-2 electronically, your due date for filing them with the Social Security Administration is March 31.

#### March 15

**Corporations.** File a 2009 calendar year income tax return (Form 1120) and pay any tax due. If you want an automatic six-month extension of time to file the return, file Form 7004 and deposit what you estimate you owe.

**S corporations.** File a 2009 calendar year income tax return (Form 1120S) and pay any tax due. Provide each shareholder with a copy of Schedule K-1 (Form 1120S), Shareholder's Share of Income, Deductions, Credits, etc., or a substitute Schedule K-1. If you want an automatic six-month extension of time to file the return, file Form 7004 and deposit what you estimate you owe.

**S corporation election.** File Form 2553, Election by a Small Business Corporation, to choose to be treated as an S corporation beginning with calendar year 2010. If Form 2553 is filed late, S treatment will begin with calendar year 2011.

**Electing large partnerships.** Provide each partner with a copy of Schedule K-1 (Form 1065-B), Partner's Share of Income (Loss) From an Electing Large Partnership, or a substitute Schedule K-1. This due date is effective for the first March 15 following the close of the partnership's tax year. The due date of March 15 applies even if the partnership requests an extension of time to file the Form 1065-B by filing Form 7004.

**Employers.** For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in February if the monthly rule applies.

### APRIL 2010

#### April 15

**Individuals.** File a 2009 income tax return. If you want an automatic six-month extension of time to file the return, file Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return, or you can get an extension by phone or online. Then file Form 1040, 1040A, or 1040EZ by October 15.

If you are not paying your 2010 income tax through withholding (or will not pay in enough tax during the year that way), pay the first installment of your 2010 estimated tax. Use Form 1040-ES.

**Employers.** For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in March if the monthly rule applies.

**Household employers.** If you paid cash wages of \$1,700 or more in 2009 to a household employee, file Schedule H (Form 1040) with your income tax return and report any employment taxes. Report any federal unemployment (FUTA) tax on Schedule H if you paid total cash wages of \$1,000 or more in any calendar quarter of 2008 or 2009 to household employees. Also report any income tax you withheld for your household employees.

**Partnerships.** File a 2009 calendar year return (Form 1065). Provide each partner with a copy of Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc., or a substitute Schedule K-1. If you want an automatic five-month extension of time to file the return and provide Schedule K-1 or a substitute Schedule K-1, file Form 7004. Then file Form 1065 by September 15.

**Electing large partnerships.** File a 2009 calendar year return (Form 1065-B). If you want an automatic six-month extension of time to file the return, file Form 7004. Then file Form 1065-B by October 15.

**Corporations.** Deposit the first installment of estimated income tax for 2010.