

LPC Tax and Business Bulletin

I. Tax News

A. Health Care Bill Preserves Health Savings Accounts.

The health care legislation passed and signed into law last week preserves Health Savings Accounts (HSAs). HSAs work as follows:

A taxpayer may deposit money into an account at any bank without paying income taxes on such amounts. The amount in the HSA grows tax-free, and there is no tax on amounts withdrawn for qualified expenses. HSAs are subject to certain restrictions:

Money from the account has to be used for health care costs; taxpayers are limited to contributing \$3,050 in 2010 (for individual coverage), \$6,150 in 2010 (for family coverage), and for taxpayers 55 years or older, an additional \$1,000 may be contributed.

There are no income-level restrictions on contributions and employers may contribute as well. As for eligibility, taxpayers may not open an HSA unless they have health insurance with an annual deductible of at least \$1,200 in 2010 (for individual coverage), and \$2,400 in 2010 (for family coverage).

HSA money must be used for health care expenses, however, if there is surplus money in the account after such health care expenses such surplus may be invested and carried forward, producing funds for health care to be used later on in life, such as in retirement or for COBRA health premiums if a taxpayer should lose their employment.

HSAs differ from health care flexible spending accounts in that the money in the account does not evaporate after any given year. For those taxpayers who are concerned about paying higher taxes because of the health care bill, HSAs offer a way to offset those higher taxes.

B. Housing Incentives.

Tax credit incentives for purchasing a home are available through April 30, 2010. Taxpayers who sell one home and buy another for less than \$800,000 by the deadline will get a \$6,500 tax credit and first-time homebuyers may receive an \$8,000 tax credit.

Eligibility Criteria: The total value of the house has to be under the \$800,000 limit, the buyers' adjusted gross income has to be less than \$245,000 a year for a married couple, the buyers must have lived in their previous home for five of the last eight years, and the new home cannot be purchased from a family member.

C. Capital Gains.

Under current law, the 2001 Bush Administration reconciliation tax act is scheduled to sunset at the end of 2010. Correspondingly, the federal long-term capital gains rate will rise from 15% to 20%. While Congress still has an opportunity to address this issue, many asset management specialists are considering 2010 as taxpayers' last chance to rebalance their portfolios at the lower 15% rate.

D. Estate Tax.

Congress has still not acted on the federal estate tax which in 2010, under the Bush 2001 reconciliation tax act, is repealed and sunsets at the end of 2010 with the estate tax returning with a \$1 million lifetime exemption and a 55% rate of tax. Within the estate planning community, a consensus opinion is that Congress will act before the end of the year (possibly retroactively) to "fix" the estate tax problem, however, a growing number of practitioners see a sunset of the current legislation as a real possibility. Readers should review their current estate planning documents with their advisors to understand and address the implications of the current law.

E. Gift Trusts.

On March 17th, the House Ways and Means Committee approved a bill that would increase the minimum length of a Grantor Retained Annuity Trust (GRAT) to ten years. Such provision is part of the Small Business and Infrastructure Jobs Tax Act of 2010. Consequently, those taxpayers who wish to set up shorter term GRATs have only until the date of the bill's enactment to do so.

F. Charitable Trusts.

As a result of the Great Recession, many taxpayers have experienced fundamental changes in their financial circumstances. For those taxpayers who set up charitable trusts, such as a Charitable Remainder Annuity Trust, an option for those with immediate needs for liquidity is to collapse the trust. The assets of the trust would pass directly to the charity and the taxpayer would receive back a sum equivalent to the present value of the future annuity stream (in exchange for the immediate access to cash, the taxpayer would face a higher immediate tax bill).

Another option for those taxpayers who could use another current deduction (such as taxpayers who converted a Roth IRA and those having elevated income tax liability) would be to accelerate the trust which would cause the donation of the income stream to a charity and obtain a second charitable deduction.

II. Legislation/Executive Activity

On March 26th, the Federal Government Announced New Initiatives to Help People Who Are Having Trouble Paying Their Mortgages. Under the new initiatives, the companies servicing affected mortgages will be required to offer at least three and up to six months of reduced payments. During such time, affected borrowers will not have to pay more than 31% of their monthly income toward the mortgage. Such borrowers have to live in the house to qualify, and the mortgage balance has to be less than \$729,750 with a monthly payment that represents more than 31% of the gross monthly income of all borrowers who signed the mortgage. If one person in the household works and one is unemployed, there would not be eligibility for such a mortgage adjustment unless the loan payment is over 31% of the current total household income. Affected borrowers need to prove they are receiving unemployment benefits and ask for help within 90 days of any late payments. The lower payments revert to regular amounts once employment is obtained, if such a borrower becomes employed before the end of three to six month period.

The government is also offering additional incentives for companies to reduce principal in situations where property is worth at least 15% less than the value of the first mortgage and where affected borrowers live in their home and have a mortgage under \$729,750 with a mortgage payment of more than 31% of their gross monthly income. Principal forgiveness will take place in three equal amounts over the course of three years, but only if the borrowers make their mortgage payments on time.

Banks are not required to participate in the government incentives program.

III. Business Highlights

House Passes Short-Term Job Creation Bill. On March 24th, the U.S. House of Representatives passed a short-term job creation bill wherein small businesses obtained \$3.6 billion in tax breaks. Included in the legislation is an exclusion from capital gains tax on small business stock (normally 50%, but raised by the Recovery Act to 75% for equity acquired in 2009 and 2010) to 100% for stock acquired through 2011; venture capital loans guaranteed by the Small Business Administration would be

classified as “at-risk” financing, thus increasing the amount of deductions a business could take. The legislation also temporarily increases, for 2010 and 2011, the deduction for small business start-up expenses from \$5,000 to \$20,000 and raises the upper limit for deductible expenses from \$50,000 to \$75,000. Interestingly, the bill also limits the penalty for failing to report on a tax return a “listed transaction” (a “listed transaction” is one which the IRS has identified as a tax-avoidance scheme).

To pay for the legislation, large corporations, such as multinationals, are targeted. The bill would prevent companies in offshore tax havens from funneling income earned in the United States through tax deductible payments to subsidiaries in such offshore tax haven. The House bill must gain Senate approval, which is working on its own legislation. Commentators see it as unlikely that the House bill will make it through the Senate intact.

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