



# Client advisor

CURRENT INFORMATION, NEWS AND TRENDS

FALL 2011 Volume XVI, Number 3

## Inside This Issue:

- Getting Older With No Retirement Savings in Sight?
- Tax Perks for the Business Traveler
- Are You Missing Out on the Research Credit?
- Rejoice – Congress Overturns Enhanced 1099 Reporting Requirements
- Taking Advantage of the Deduction for Domestic Production Activities?
- Tax Calendar
- Since You Asked...

## Getting Older With No Retirement Savings in Sight?

One of the earliest lessons in life is that actions have consequences, and approaching retirement age without a substantial nest egg is one of those consequences. But if you are in this situation, you are not alone, as millions of other Americans are faced with the same need to save enough to retire comfortably.

Our priorities shift throughout our lives. Early in the life cycle, home ownership is a priority; that is usually followed by raising and educating children. However, as retirement approaches, the focus needs to shift toward retirement funding. By the time most people are 45 or 50, their children are on their own, the mortgage is close to being paid off, and there is more discretionary income to set aside for retirement.

If you are starting to think about retirement, there are three pitfalls you need to avoid: (1) retiring on your birthday instead of your bank account, (2) not properly managing your risk and (3) retiring with too much debt.

A frequently asked question is “How much do I need to put aside for retirement?” The answer to that question varies with each individual. There are a number of factors to consider: current income, existing savings, assets, how many years until you plan to retire, the lifestyle you want in retirement, and what you can afford to put aside.

If you want to make a rough estimate of the savings needed, determine your approximate income needs and calculate the amount of money you will receive, aside from your savings. These other sources could be your Social Security benefit, a pension, or an IRA or a 401(k) plan.

Add up all of the funds that will come from your Social Security benefit, pension, etc., and determine a savings goal that will, after retirement, provide the additional income needed for retirement. Be sure to factor in inflation and a reasonable rate of return, taking into consideration today's tough economic environment. Also consider your existing savings and assets that help fund retirement.

Then start figuring out how to make up for the difference. Here are some suggestions:

**1.** Check to see whether your employer offers a 401(k), a 403(b), or some other type of voluntary contribution retirement plan. Take advantage of these plans and contribute the maximum you can afford up to the annual limit, which for 2011 is:

- \$16,500 for taxpayers below 50 years of age, and
- \$22,000 for taxpayers 50 years of age and over.

The contribution is before taxes, so making the contribution will lower your gross income and reduce your current tax bite. Also, if your employer matches a percentage of your contribution, that is free money for you.

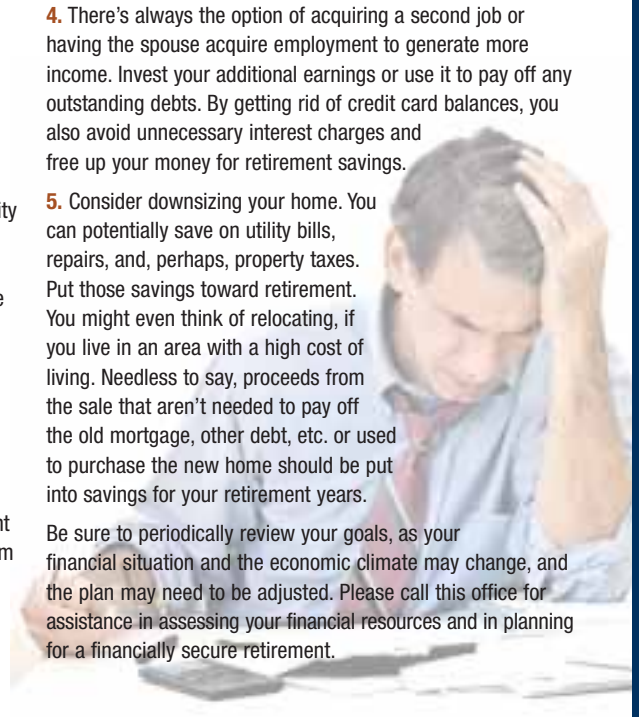
**2.** If you have earned income (or receive alimony) but don't have an employer plan to contribute to, or if you can afford to set aside additional funds, you might consider an IRA. Here, you have a choice between a traditional IRA and a Roth IRA. Traditional IRA contributions can be tax deductible or not, depending on your income and whether you have an employer retirement plan. Roth IRAs are not tax deductible, but accrue earnings tax-free. However, contributing to a Roth IRA can be complicated for higher-income taxpayers. The IRA contribution limit for 2011 is \$5,000 (\$6,000 if age 50 and over). In some cases, a spouse can also contribute to an IRA based on the other spouse's earned income.

**3.** Self-employed individuals can take advantage of a variety of available defined contribution retirement plans that allow contributions nearing 20% on the self-employed individual's net income, limited to a maximum of \$49,000 for 2011. There are also more complicated defined benefit plans available that allow substantially higher contributions.

**4.** There's always the option of acquiring a second job or having the spouse acquire employment to generate more income. Invest your additional earnings or use it to pay off any outstanding debts. By getting rid of credit card balances, you also avoid unnecessary interest charges and free up your money for retirement savings.

**5.** Consider downsizing your home. You can potentially save on utility bills, repairs, and, perhaps, property taxes. Put those savings toward retirement. You might even think of relocating, if you live in an area with a high cost of living. Needless to say, proceeds from the sale that aren't needed to pay off the old mortgage, other debt, etc. or used to purchase the new home should be put into savings for your retirement years.

Be sure to periodically review your goals, as your financial situation and the economic climate may change, and the plan may need to be adjusted. Please call this office for assistance in assessing your financial resources and in planning for a financially secure retirement.



# Tax Perks For the Business Traveler

**F**ood and lodging expenses may be deducted when you are away from home for business purposes. There are certain rules to follow, and the individuals that know the rules and keep good records get the most out of these deductions.

The IRS requires that lodging expenses (and other expenses of \$75 or more) be substantiated by records or other evidence. Acceptable records include diaries, logs, receipts, paid bills and expense reports. The records should disclose the amount, date, place and essential character of the expense. The following are some tips to help you stay on top of the required documentation:

- Keep good records of travel expenses.
- Maintain the records on a contemporaneous basis, i.e., make diary and log notations close to the time the expense is incurred.
- Document the business purpose and the expected business benefit.
- Retain your travel itinerary to document the business activity while away.

Travel expenses are deductible only if the individual is away from his or her "tax home"—usually considered to be one's regular place of business—for more than one business day.

Meal expenses are deductible only if the trip is overnight or long enough that there is a need to stop for sleep or rest to properly perform one's duties. The amount of the meal expenses must be substantiated, but instead of keeping records of the actual cost of meal expenses, a "standard meal allowance" ranging from \$46 to \$71 can generally be used, depending on where and when the individual travels. Generally, the deduction for unreimbursed business meals is limited to 50% of the cost that would otherwise be deductible.

Lodging expenses must be substantiated with receipts and are 100% deductible. Meals included in lodging expenses, such as room service or dining costs charged to a hotel room, must be separately identified, since meals have the 50% limitation as noted.

In addition to the travel, lodging and meal expenses discussed, the incidental costs incurred on a deductible trip such as laundry, dry cleaning, phone calls, baggage handling, and so on are fully deductible.

Employees must deduct their unreimbursed travel expenses as a miscellaneous itemized deduction, which is subject to a 2% of AGI floor. They are not deductible at all to the extent the employee's income is subject to the alternative minimum tax (AMT). That is why it is to an employee's advantage to utilize an employer's "accountable" reimbursement plan (under which qualified reimbursements are not taxable and not reported in the employee's W-2 wages) rather than deducting the expenses on their tax returns. On the other hand, these expenses are fully deductible as a business expense for a self-employed individual.

Taking the spouse along? Generally, deductions are denied for travel expenses paid or incurred for a spouse, dependent or employee of the taxpayer who accompanies the taxpayer on the business trip unless the:

- (1) Spouse or dependent is an employee of the taxpayer, and
- (2) Travel of the spouse, dependent or employee is for a bona fide business purpose, and
- (3) Expenses would otherwise be deductible by the spouse, dependent or employee.

**Strategy**—The law allows a deduction for the single rate for lodging and frequently there is no rate difference between one or two occupants. Thus, the entire lodging expense for the spouse will virtually be deductible. When traveling by car, the law does not require any allocation because the spouse is also traveling in the vehicle. Thus, if you are traveling by vehicle, the entire cost of the transportation would be deductible. That would generally also apply to taxis at the destination. The only substantial cost that is not allowed is the cost of the spouse's meals, which, even if they were deductible, would be reduced by the 50% rule. If traveling by air or rail, the cost of the spouse's tickets also would not be deductible.

Please give this office a call if you have questions related to business travel expenses.

## Are You Missing Out On the Research Credit?

The Tax Code provides a tax credit of up to 20% of qualified expenditures for businesses that develop, design or improve products, processes, techniques, formulas or software and similar activities. Without Congressional action, this credit will expire at the end of 2011.

The credit is calculated on the basis of increases in research activities and expenditures. Its purpose is to reward businesses that pursue innovation by continually increasing investment. An alternative simplified method allows taxpayers to claim research credits if research costs remain the same or even decline when compared with prior years.

The two methods used to compute the credit are the regular method that provides for the 20% credit, or the simplified method, which is easier to document but results in reduced credit amounts.

**Regular Method**—Under the regular research credit method, the credit equals 20% of qualified research expenditures for a tax year over a base amount established by the taxpayer in 1984–1988 or by another method for companies that started up subsequently.

**Simplified Method**—The alternative simplified method credit equals 14% of qualified research expenses over 50% of the average annual qualified research expenses in the

three immediately preceding tax years. If the taxpayer has no qualified research expenses in any of the three preceding tax years, the alternative simplified method credit may be 6% of the tax year's qualified research expenses. This method may be the best choice for taxpayers with incomplete records from the mid-1980s, those complicated by mergers and acquisitions, or taxpayers with a high base amount from that period.

**Qualified Research**—The term "qualified research" means research which is undertaken for the purpose of discovering information which is technological in nature, and the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and relates to:

- A new or improved function,
- Performance, or
- Reliability or quality.

Certain purposes that are not qualified include style, taste, cosmetic, or seasonal design factors. The definition is relatively broad and encompasses such activities as:

- Developing new or improved products, processes or formulas;
- Developing prototypes or models;

- Developing or applying for patents;
- Certification testing;
- Developing new technology;
- Environmental testing;
- Developing or improving software technologies;
- Building or improving manufacturing facilities; and
- Streamlining internal processes.

**Qualifying Research Expenditures** – Generally, expenses that qualify for the credit include in-house wages and supplies attributable to the qualified research; computer time-sharing costs; 65% of contract research expenses (paid to outside contractors in the U.S. who are conducting qualified research on the taxpayer's behalf); and supplies directly used in the conduct of the qualified research.

**Note:** Alternatively, research and experimental expenses may be deducted or capitalized under Sec 174 of the Internal Revenue Code. However, a taxpayer must elect either to deduct or amortize such expenses OR claim the credit for them.

**Limitations** – The R&D credit is also subject to limitations of the general business credit. Its total and others included in the general business credit are limited to 25% of the taxpayer's net tax liability over \$25,000. To the extent that a research credit is not available for use in the current year or immediate prior year, unused credits have a 20-year carry forward.

If you have questions related to this credit or need assistance in developing the base amounts needed to compute this credit, please give this office a call.

## Rejoice - Congress Overturns Enhanced 1099 Reporting Requirements

In earlier newsletters, we had notified you of two new 1099 reporting requirements for business and rentals. These included:

**For Rental Owners** – The new requirement for rental owners to report annual payments of \$600 or more to service providers such as a pool service person, handyman, gardener, management company and other unincorporated service providers effective for the 2011 and future tax years.

**For Business Owners** – The new requirement to include incorporated entities in the business 1099 reporting requirements and expanding the scope to include purchases in addition to payment for services. This provision was to become effective for the 2012 and subsequent tax years.

In response to overwhelming objections from business leaders, business organizations and accounting professionals nationwide complaining about the tax compliance burden these new requirement impose on taxpayers, particularly small businesses, Congress has repealed these requirements.

However, the existing 1099 reporting requirements for businesses remain in effect.

If you have questions, please give this office a call.

# Taking Advantage of the Deduction for Domestic Production Activities?

The domestic production activities deduction was created to encourage manufacturing and production within the U.S., and it provides a substantial business deduction equal to 9% of the lesser of:

- (1) The taxpayer's net income from qualified production activities or
- (2) The taxable income (modified adjusted gross income for individual taxpayers) without regard to this deduction for the tax year.

The deduction is further limited to 50% of the W-2 wages of the employer for the tax year allocable to the activities eligible for the deduction.

**Domestic Production Activities** – Although the definition of "domestic production activity" is a little elusive, it generally does not include retail sales or purely service activities. Among the more common eligible activities are:

- Manufacturing and production activities in whole or in significant part within the U.S.,
- Construction of real property in the U.S., and
- Performance of engineering or architectural services in the U.S. in connection with real property construction projects in the U.S.

The following example, one that was used in a Congressional hearing, does a good job of defining what is and is not a qualified domestic production activity: Suppose you are a baker and in the business of producing donuts. Some of the donuts you sell retail directly to the consumers, and some you sell in bulk to hotels and restaurants. The production costs of the donuts sold at retail do not qualify for the deduction, while the costs associated with the wholesale sales to the hotels and restaurants do.

**Example of how the deduction is determined** – ABC, Inc. produces widgets in the U.S. that it wholesales to retailers. The company's revenue from the sale of the widgets is \$2 million, with a manufacturing cost of \$950,000. ABC, Inc. also has \$1 million of income from widget repair services. The total W-2 wages for the year were \$400,000, of which \$150,000 is properly allocated to the widget manufacturing costs and the balance used to provide the repair services. The deduction would be determined as follows:

Qualified Production Activity Income (widget sales)	\$2,000,000
Cost of Manufacturing the Widgets Sold	< 950,000 >
Net Income	1,050,000
9% of the Net Income	94,500 A
Wages Attributable to the Widget Production	150,000
50% of Wage Limitation	75,000 B
Domestic Production Deduction (lesser of A or B)	\$ 75,000

The deduction on ABC Inc.'s tax return will be limited to the company's taxable income. This example is rather a simplistic illustration of how the deduction is determined. In actual practice, inventory, cost of goods, determination of qualified production wages, and so on all have rules, procedures and complications of their own. However, the deduction can be very beneficial and well worth the added accounting. In fact, most taxpayers who qualify for the deduction are required to claim it, even if the administrative costs of applying the law and regulations outweigh the benefit of claiming the deduction.

**Who Gets the Deduction** – This deduction is allowed to all taxpayers, including individuals, C corporations, farming cooperatives, estates, trusts, and their beneficiaries. The deduction is allowed to partners and owners of S corporations (not to partnerships or the S corporations themselves) and may be passed by farming cooperatives to their patrons. And, despite the deduction's history, it is fully available to taxpayers who do not export.

The foregoing is an overview of this deduction. If you have questions related to how the domestic production deduction might apply to your specific circumstances, please give this office a call.



# Tax calendar

Sep. – Dec. 2011

## September – December:

- Time for your 2011 and 2012 Tax Planning. Contact this office to schedule a consultation appointment.

## September 15, 2011:

- The third installment of 2011 individual estimated taxes is due.
- This is the FINAL extended filing due date for your 2010 calendar year partnership returns (Form 1065), fiduciary returns (Form 1041), S corporation returns (Form 1120S), and corporation returns (Form 1120).

## October 17, 2011:

- This is the FINAL extended filing due date for your 2010 individual income tax return.

## December 31, 2011:

- Last day for taxpayers who began their minimum IRA distributions in a year before 2011 to make their required withdrawals for 2011. As Dec. 31st is a Saturday in 2011, to allow IRA trustees/custodians ample time to process distribution payments, taxpayers should request distributions well ahead of this date.
- This is generally the LAST day that you can pay tax-deductible expenses for the year. IRA contributions and some self-employed retirement plan contributions can be made after the close of the year.

The purpose of this newsletter is to provide current information on tax, financial and business developments. It suggests general tax planning ideas that may only be appropriate when claiming tax benefits in a manner consistent with the statutes and Congressional purpose. The information and opinions are generalizations and may not apply to all taxpayers and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. Therefore, it is important that you seek appropriate advice before implementing any of the ideas suggested.

## Client advisor

CURRENT INFORMATION, NEWS AND TRENDS

## Since You Asked...



**You Asked:** I took a hardship loan from my employer's 401(k) plan, and I am unable to continue making the payments. What will happen?

**Answer:** Hardship loans up to \$50,000 are permitted from most employer plans, and there are no tax implications as long as the loan is paid back in installments over a period not to exceed five years. If you stop making the loan payments, the employer is required to treat the balance due as a deemed distribution, making the entire balance immediately taxable. In addition, if you are under the age of 59½, the distribution will be subject to the federal 10% early withdrawal penalty; your state may also impose a penalty. You should first consider other alternatives, as the tax result can be severe.

**You Asked:** About mid-year last year, my firm hired some new employees, and we were not required to pay the employer's share of the 6.2% payroll tax on their wages. I seem to remember that some additional benefit applied for 2011. Can you enlighten me?

**Answer:** Yes; As an incentive for hiring certain unemployed individuals in 2010, employers were exempt from the employer's share of payroll tax on those individuals. Then, as an incentive to continue to retain those workers in 2011, the employer is granted a tax credit in 2011 equal to the lesser of \$1,000 or 6.2% of the wages for each employee. However, to qualify for the credit, the employee must have been employed for a continuous 52-week period, and the employee's pay in the second half of that period must be at least 80% of the first half's pay.