LMGW
Certified Public Accountants, LLP
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A Closer Look at the Mortgage Interest Deduction Rules

The rules on deducting mortgage interest are complex, convoluted and fraught with pitfalls for the unwary. To make matters worse, different rules apply for regular tax and the dreaded alternative minimum tax. Let's try to clear things up by looking at the rules and some basic definitions:

Acquisition Debt: Debt incurred to purchase, acquire, or substantially improve your principal residence. You may deduct interest on up to $1 million of debt on your principal or second home. Furthermore, the debt must be secured by the home.

Home Equity Debt: Debt secured by your principal or second home, or acquisition debt that is in excess of the $1MM limitation. You may also deduct interest on up to $100k of Home Equity Debt regardless of the use of the proceeds for regular tax, however this deduction is not allowed for AMT.

These rules seem simple enough, but take a look at the following examples:

Curley bought his home in 1990 for $200,000 for which he borrowed $160,000. In 2010 he owes $400,000 as a result of refinancing cash out to pay for raising a family, sending his kids to college and a wedding. With the $400,000 loan at 6%, Curley pays $24,000 in mortgage interest expense for the year. For regular tax purposes, Curley may deduct $15,600 of the mortgage interest paid. This is comprised of the interest on the original $160,000 acquisition debt (assume no principal paid) and $100,000 of the debt incurred in the refinance (the home equity debt.) For AMT purposes Curley may only deduct $9,600, which is the interest on the $160,000 of original acquisition debt. Because the proceeds from the refinance were used for personal expenses, the interest is not deductible for AMT purposes.

Larry also tapped the equity in his home, adding $240,000 to existing acquisition debt of $160,000, but used the money as a down payment on a vacation home. No problem - the additional money was used to buy a second home right? Wrong - due to the fact that the loan was secured against the principal residence and not the vacation home. Remember, the loan must be secured by the home purchased with the loan proceeds. Larry's interest deduction for regular tax and AMT are exactly the same as Curley's.

Finally, Mo borrowed $150,000 from his parents for a down payment on his home. Mo is unable to deduct any interest paid on the loan from his parents because his parents did not secure the loan against the home. This is just the tip of the iceberg when it comes to the mortgage interest rules. Call your LMGW tax advisor before you go fishing for a new loan, to discuss the tax implications as well as possible alternatives.

Haiti Relief - Charitable Contributions

On January 20, 2010, the House approved by voice vote H.R.4462, a bill to accelerate the income tax benefits for charitable contributions for the relief of victims of the earthquake in Haiti. Under the bill, Haitian relief donors could elect to treat contributions made after Jan. 11, 2010, and before Mar. 1, 2010, as if the contributions had been made on Dec. 31, 2009. If the election is made, Haiti relief donations would be deductible on the 2009 return, not the 2010 return. This option is available only if the contribution is made in cash (check or credit card) and otherwise meets the requirements for charitable contribution deductions under Code Sec. 170.

GOTCHA!

IRS Commissioner Uses Tax Preparer

Douglas Shulman became the Commissioner of the Internal Revenue Service in March of 2008. He holds a Bachelor of Arts degree from Williams College, a Master of Public Administration degree from Harvard University's John F. Kennedy School of Government, and a Juris Doctor degree (magna cum laude) from Georgetown University Law Center.

But Doug Shulman does not prepare his own tax return! In an interview with C-SPAN in January 2010, Commissioner Shulman stated, "I use a preparer. I've used one for years. I find it convenient. I find the tax code complex, so I use a preparer."[1]

It's no wonder the majority of taxpayers have a difficult time navigating the tax code. The Commissioner's statement emphasizes the importance using not just a tax preparer, but a competent tax preparer.

LMGW prides itself on its highly skilled staff and we are proud to be part of your tax advisory team.

1 http://www.c-spanvideo.org/program/291155-1

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New Law Alerts

• Income Tax—Disaster Relief Scams: The same advice the IRS provided in the wake of Hurricane Katrina applies to the Haitian earthquake and other natural disasters: (1) don't give out personal financial information, such as Social Security Numbers or credit card or bank account numbers, to solicitors of contributions; (2) don't send cash, but contribute by check or credit card instead; and (3) be wary of charities with names that sound familiar or similar to nationally known organizations. The IRS website has a list of organizations (www.IRS.gov/charities. Click "Search for Charities") that are eligible to receive deductible contributions.[1]

• Recapture of first-time homebuyer credit: Taxpayers who claimed a Code Sec. 36 first-time homebuyer credit (FTHTC) for homes bought after Apr. 8, 2008, and before Jan. 1, 2009, must begin repaying the credit in 2010. The FTHTC must generally be recaptured (i.e., repaid) in equal installments over a 15-year period. Recapture is accelerated if a taxpayer disposes of his residence or it ceases to be the taxpayer's principal residence before the end of the 15-year recapture period. Remember, the recapture rules do not apply to credits taken on homes purchased after December 31, 2008 provided the home remains the taxpayer's principal residence for 36 months after the purchase date.

• 2010 Standard Mileage Rates: Beginning January 1, 2010, the standard mileage rates are 50 cents per mile for business miles, 16.5 cents per mile for medical and moving miles, and 14 cents per mile for charitable miles.

• CA Failure to File Penalty for Change in Ownership Statements: If you are a partnership, corporation or LLC with a California filing requirement you may have noticed three questions relating to transfers of stock or other interest on your California tax return. These questions are designed to alert the FTB of ownership changes within an entity and the possible property tax reassessment that may result from that change. A person acquiring an interest in an entity is required to file Form BOE-100-B within 45 days of an ownership change. Beginning January 1, 2010, there will be a penalty for failing to file Form BOE-100-B. The penalty will be equal to 10% of the real property tax amount.

• No E-Pay Penalties in 2010: The FTB has announced they will not impose penalties on individuals who fail to make mandatory e-pay tax payments. Currently, taxpayers who make a payment of more than $20,000 or who have a tax liability of more than $80,000 are required to make future payments electronically. The FTB will waive the penalty for failure to submit required electronic payments in 2010.

• CA Use Tax Returns: You may have read about the new CA use tax registration requirements in our 3rd qtr 2009 newsletter. As a reminder, the BOE is requiring businesses and individuals who receive at least $100,000 in gross receipts from business operations or rental property to register with the BOE. Beginning in March 2010, the BOE will be mailing out registration information to all businesses and individuals who met this requirement based on the information reported on their 2007 federal return. These taxpayers will be required to electronically file their 2009 use tax returns by April 15, 2010. Keep in mind a return is required even if there is no use tax due.

1 Thomsons Reuters Checkpoint

Forensic Accountants and Divorce

Divorce can be an uncomfortable topic to discuss, especially with your accountant, but forensic accountants can play a key role in a marital dissolution. Although not required for all marital dissolutions, many of the more complicated cases can greatly benefit from the services of a forensic accountant. Some reasons to retain a forensic accountant include:

- Uncovering unreported income, especially if one or both of the spouses is self-employed;
- Separate property claims;
- Temporary and permanent spousal and child support;
- Determination of the marital lifestyle;
- Reimbursements, tracing, allocation, apportionment and characterization of assets;
- Valuation of a business interest;
- Business, executive, professional or celebrity goodwill;
- Commingling of funds;
- Reimbursement claims for post-separation maintenance of community assets;

During a divorce, there is a need to communicate with opposing parties, attorneys, and judges. The stress and distractions of divorce can make communicating effectively a challenge. This is particularly true when trying to communicate the significance of property, income, and other information needed in divorce proceedings to attorneys, soon-to-be former spouses and possibly a mediator or judge. Clearly laying out key ideas and arguments supporting divorce matters can be critical to successful negotiation. Including visual tools such as tables, charts and graphs can help make and emphasize key points. Clear communication can help achieve a satisfactory solution in a timely manner as both sides can clearly see the facts and figures. Keith Plottel, Managing Partner of LMGW has been providing forensic accounting services for marital dissolutions and other matters for over 20 years. Contact Keith to help facilitate timely resolutions if you find yourself in need of a forensic accountant.

Featured Staff Member

Gregory S. Genetti, CPA - Partner

Greg is one of the original members of LMGW and started practicing public accounting in 1983. He began his public accounting career with Pearson, Del Prete and Co. in Palo Alto, California, and later started his own practice in Los Gatos. In 1999, he merged with Lanier & Madej, CPAs to form what is now LMGW CPAs, LLP.

Greg specializes in individual and business taxation, including corporations, partnerships and LLCs. In addition, he assists his clients with business entity selection and organization, tax planning, estate and trust taxation and planning, and financial statement review and compilation. With the changing needs in industry and LMGW's commitment to providing new services to its clients, Greg has also added business and asset valuation to the list of services he offers his clients.

In addition to his accounting and taxation knowledge, Greg also has significant business development experience including the founding and management of a venture group which built and operated a cellular telephone system in north-western South Dakota and serving as Chief Financial Officer of a food distributor providing products throughout the western United States. He was also a Founder and Chief Financial Officer of a radio station operating in the San Francisco Bay Area.

Greg is a graduate of San Jose State University and an active community member. He has been an instructor of adult education programs in financial curriculums at Foothill College. Currently, Greg is the Treasurer of the Northern California Lupus Foundation and served for 10 years as the Treasurer of the Serra Club of San Jose. He is also an active member of the San Jose Chamber of Commerce.

While away from the office Greg enjoys spending time with his wife and four children, exploring the gold country, and participating in family and community activities.

FIN 48 - New Income Tax Accounting for Non-Profits

If you are a non-profit organization you may have heard about FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48) and just brushed it aside. But pay attention, as FIN 48 now applies to not-for-profit entities. The effective date for nonpublic entities, including not-for-profit entities to adopt FIN 48 is for fiscal years beginning after December 15, 2008. That means for entities that have a 12/31 year end, FIN 48 is applicable for 2009. The IRS will require a copy of the FIN 48 accrual footnote that is presented in the audited financial statements with the entity's Form 990.

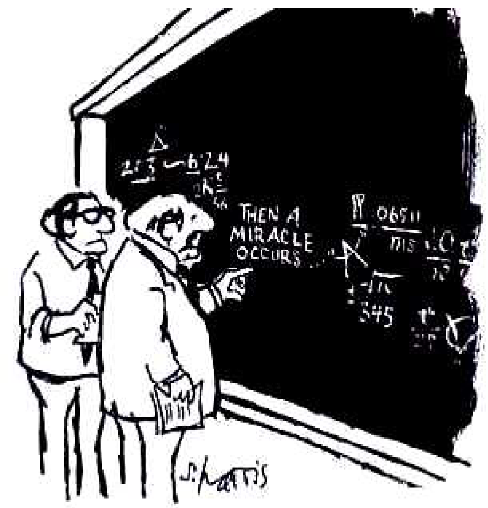
So what exactly is FIN 48? And why is it applicable to not-for-profit entities that are generally exempt from tax? In the basic sense, FIN48 requires that the tax effects of an event be recorded in the period that the event occurs, rather than when the tax effects are actually realized. The purpose of FIN 48 is to bring consistency as to when an accrual for income taxes is recorded.

When deciding if an income tax accrual is needed, FIN 48 requires the following assumptions:

- All of its income tax returns will be examined by the appropriate taxing authorities. (Assumes an audit will occur.)
- The examiners will have all the information. (They will know what you know.)

Not-for-profits must consider any additional taxes that may be due on the tax positions. A liability must be booked for taxes with a greater than 50% chance of being assessed by the proper taxing authorities.

It is important to note that FIN 48 is related to income tax positions, so sales, property, payroll and other non-income taxes are not within the scope. Please contact Terry Lanier or Michael Bryant at LMGW, Certified Public Accountants, LLP with any questions you may have about the adoption of FIN 48. Also visit our website at www.lmgw.com for an expanded article on FIN 48.



"I THINK YOU SHOULD BE MORE EXPLICIT HERE IN STEP TWO."

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