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Tax and Business Alert™

September 2010

If escalating energy costs have you looking for ways to reduce your gas and electric bills, here are some tips on how you can cut costs and reap tax-saving energy credits as well.

A great way to cut energy costs and save up to $1,500 in federal income taxes is to make certain energy-efficient improvements to your home. But, you need to be sure to pick the right product.

The Nonbusiness Energy Property Credit equals 30% of what you pay for (a) qualified energy-efficient improvements (such as certain energy-efficient insulation, windows, doors, and roofs) and (b) qualified residential energy property (such as certain energy-efficient heat pumps, hot water heaters or boilers, and advanced main air circulating fans) on your principal residence (no vacation homes). Expenditures made from subsidized energy financing provided by federal, state, and local government programs can qualify for the credit if they otherwise meet the requirements for those credits. However, there is a $1,500 cap on aggregate credits claimed in 2009 and 2010 for all types of eligible expenditures. In other words, the $1,500 cap applies to the total amount of energy credits claimed in both years combined.

Energy-Efficient Tax Credits

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Although the costs of qualifying expenditures tend to be pretty high, if you install solar, wind, geothermal, or fuel cell energy-saving equipment in 2010, you may be able to take advantage of the Residential Energy Efficient Property (REEP) Credit. The REEP credit equals 30% of expenditures to purchase and install: (1) qualified solar water heating equipment, (2) qualified small wind energy equipment, (3) qualified geothermal heat pumps, (4) qualified solar electricity generation equipment, and (5) qualified fuel cell equipment (up to $1,000 per kilowatt hour). Expenditures made from subsidized energy financing provided by federal, state, and local government programs can qualify for the REEP credit if they otherwise meet the requirements for those credits.

The REEP credit only applies to equipment placed in service in your U.S. residence, but it

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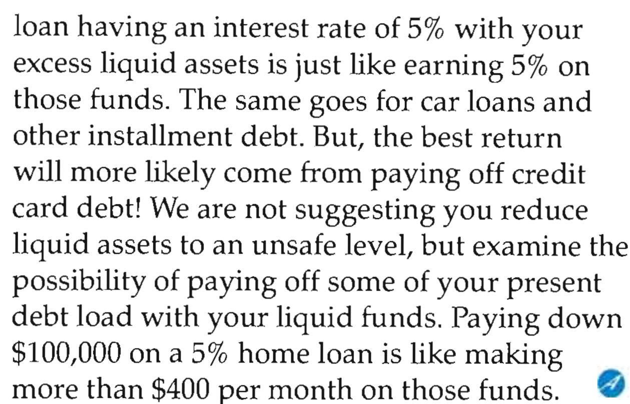
The information contained in this newsletter was not intended or written to be used and cannot be used for the purpose of (1) avoiding tax-related penalties prescribed by the Internal Revenue Code or (2) promoting or marketing any tax-related matter addressed herein.

Earn 5% or More on Liquid Assets

Yes, that is too good to be true, but we got your attention. As you are painfully aware, it is extremely difficult to earn much, if any, interest on savings, money market funds, or CDs these days. So, what are we to do? Well, one way to improve the earnings on those idle funds is to pay down debt. Paying off a home



loan having an interest rate of 5% with your excess liquid assets is just like earning 5% on those funds. The same goes for car loans and other installment debt. But, the best return will more likely come from paying off credit card debt! We are not suggesting you reduce liquid assets to an unsafe level, but examine the possibility of paying off some of your present debt load with your liquid funds. Paying down $100,000 on a 5% home loan is like making more than $400 per month on those funds.

2011 HSA Limitations

Health Savings Accounts (HSAs) were created as a tax-favored framework to provide health care benefits. HSAs are targeted mainly at the self-employed, small business owners, and employees of small to medium-sized companies who do not have access to health insurance.

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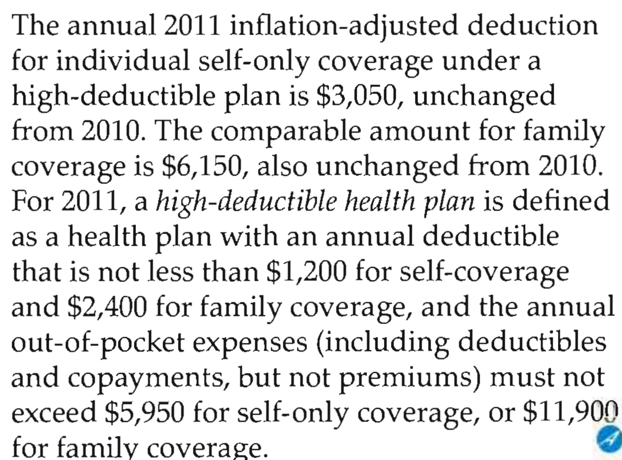
The tax benefits of HSAs are quite favorable and substantial. Eligible individuals can make tax deductible (as an adjustment to AGI) contributions into HSA accounts. The funds in the account may be invested (somewhat like an IRA), so there is an opportunity for growth. The



earnings inside the HSA are free from federal income tax, and funds withdrawn to pay eligible health care costs are tax-free. The dual benefit of tax-deductible contributions into and tax-free withdrawals from HSAs (and existing Medical Savings Accounts) is truly unique. No other tax-deferred type of account currently exists that offers such a benefit.

The annual 2011 inflation-adjusted deduction for individual self-only coverage under a high-deductible plan is $3,050, unchanged from 2010. The comparable amount for family coverage is $6,150, also unchanged from 2010. For 2011, a *high-deductible health plan* is defined as a health plan with an annual deductible that is not less than $1,200 for self-coverage and $2,400 for family coverage, and the annual out-of-pocket expenses (including deductibles and copayments, but not premiums) must not exceed $5,950 for self-only coverage, or $11,900 for family coverage.

Energy-Efficient Tax Credits

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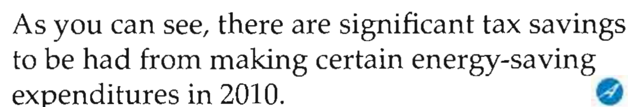
cannot be claimed for equipment used to heat a swimming pool or hot tub. In addition, the credit for fuel cell equipment is only available for your principal residence.

A good place to start your research for these credits is at **www.energystar.gov/taxcredits**, where you'll find a table listing requirements for various products. Then, to ensure the product satisfies the required energy-saving conditions for the appropriate credit, be sure to check the product package materials or manufacturer website before making the purchase. According to the IRS, you can rely on the manufacturer's written certification statement, which is typically included with the product package materials or on the manufacturer's website. You just need to keep a copy of this certification as part of your tax records.



As you can see, there are significant tax savings to be had from making certain energy-saving expenditures in 2010.

Maximizing Business Transportation Expense Deductions

The costs of commuting from a personal residence to places of business or employment generally are nondeductible personal expenditures. The deduction for commuting costs is disallowed regardless of the distance involved.

However, taxpayers whose residences qualify as their *principal place of business* can deduct transportation expenses incurred in going between their residence and other work locations in the same trade or business (including regular or temporary work locations), regardless of the distance. In the landmark *Soliman* case, the Supreme Court identified two factors for determining whether a home office qualifies as the taxpayer's principal place of business: (1) the relative importance of the activities performed at each business location and (2) the time spent at each place.

A taxpayer can meet other tests to qualify his or her residence for the home office deduction. But, the principal place of business test must be met for transportation costs between the residence and other work locations to be deductible.

For an *employee* to deduct daily transportation costs between a residence and other work locations in the same trade or business, the home office must be for the convenience of the employer in addition to being used *exclusively* and *regularly* as the principal place of business.

Whether telecommuters (i.e., employees who work from their residence much or all of the time) can deduct their local transportation costs depends on the particular facts. However, their home offices often will fail to qualify as their principal place of business for tax purposes because they do not satisfy the criteria mentioned above. Thus, if they also maintain an office at their employer's place of business, the cost of going between their residence and the employer's office is nondeductible.

Example: Management consultant with home office.

Jack is a self-employed management consultant for a variety of small businesses. He maintains a home office used regularly and exclusively to set up appointments, store client files, and develop management reports for his clients. Jack does most of his consulting work by telephone, email, or mail from his home office. He routinely uses his personal auto to travel from his home to meet with prospective and current business customers or their representatives. His home office qualifies as his principal place of business.

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Because Jack meets the principal-place-of-business/home-office criteria, his mileage traveling from his residence to see clients, to work at other regular or temporary work locations, or to perform other business duties is a deductible business expense.

Taxpayers who do not have a home office that qualifies as their principal place of business can still deduct the cost of daily transportation expenses incurred in going from their residence to temporary work locations in the following circumstances: (a) when the location is a temporary work site outside the metropolitan area where he or she lives and normally works (because there is no fixed place of business, the entire metropolitan area is deemed the workplace) or (b) a taxpayer who has one or more regular work locations away from home can deduct the cost of transportation from the home to a temporary work site in the same trade or business, regardless of the distance or whether the site is inside or outside the residential metropolitan area. Generally, a metropolitan area includes the area within the city limits and the suburbs that are considered part of that area.

Note: When a taxpayer has two or more regular work locations (whether in the same business or different businesses), the daily transportation costs of going between these work locations are deductible.

MRDs Required in 2010

Legislation in 2008 waived the Minimum Required Distributions (MRDs) for 2009 from IRAs and defined contribution plans, including Section 401(k), 403(b), and state-sponsored Section 457 plans. It did not otherwise change MRD rules. Therefore, MRDs are once again required in 2010.

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The 2009 waiver has no impact on the 2010 MRDs of taxpayers who reached 70½ before 2009. These taxpayers compute their 2010 MRDs as they normally would. For taxpayers subject to the five-year distribution rule, 2009 is not counted as one of the five years. This impacts any account using the five-year rule whose account owner died in 2004 through 2008—basically, the five-year period is extended by one year.

Under the normal MRD rules, taxpayers who reached 70½ in 2009 would have had until April 1, 2010, to take their first MRD. But, since that distribution pertained to 2009, it was waived. However, the waiver did not change the individual's required beginning date. Therefore, the 2010 MRD for a taxpayer who reached 70½ in 2009 must be made no later than December 31, 2010.

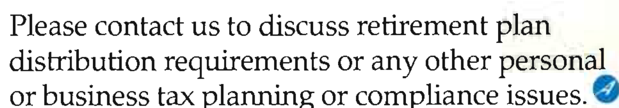
Example: MRDs for a taxpayer who reached 70½ in 2009.

Lori reached 70½ in 2009. Her first MRD (for 2009) normally would have been required no later than April 1, 2010. However, since 2009 MRDs were waived, Lori did not take the 2009 distribution. She must take a 2010 MRD by December 31, 2010.

As a reminder, failure to take required distributions will subject you to a 50% penalty. So, it is very important to compute the correct distribution amount and take the 2010 distribution in a timely manner.

Observation: There is no requirement that a taxpayer who mistakenly fails to receive an MRD in one year make a catch-up distribution in the following year. Instead, the amount that must be distributed in the following year is determined without regard to the fact that the taxpayer failed to receive the MRD in the previous tax year.

Beneficiary Designations. This is a good time to review your beneficiary designation forms and IRA documents. At your death, your beneficiary designations and the terms of your IRA will control not only who will receive those assets, but also the availability of various postmortem planning opportunities for your heirs. Given the right set of circumstances, it may be possible for your IRA assets to continue to grow in their tax-advantaged environment for many years.


Please contact us to discuss retirement plan distribution requirements or any other personal or business tax planning or compliance issues.

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