Willson & Pechacek, P.L.C. Newsletter

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Tax Changes on the Horizon

Absent some sudden and extraordinary action by Congress and the President before the end of the year, we are currently facing the largest tax increase in U.S. history.

On January 1, 2011 the estate tax is set to surge from 0% to 55% for estates over $1 million. Thus, for many estates Uncle Sam may end up getting more than the beneficiaries.

Looking further out, the tax increases needed to pay for the massive health care overhaul are now on the horizon. These tax increases, such as 2013's new 3.8% Medicare tax on certain unearned income, do not affect all types of income equally and will be another factor in long-term tax planning. See article on page 2.

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As part of the government's push towards e-filing, banks will no longer accept the paper federal tax depository coupons. Instead, taxpayers must register to make the payments electronically, as described in the article on page 2.

The tax news is not all bad. As discussed in the article below, the maximum amount of Section 179 expensing (which allows taxpayers to deduct the cost of most business equipment in the first year) doubles to up to $500,000 of qualifying equipment in 2010 and 2011.

Further, Iowa's potential exclusion of capital gain income remains a significant tax advantage for those selling certain business real estate or the business itself. See article on page 3.

As always, we are closely monitoring the ever-changing tax landscape to ensure that our clients receive updated tax advice.

-Frank W. Pechacek, Jr.

Estate Tax on Track to Return at a rate of 55% January 1, 2011

It is now almost certain that Congress will not pass a revised estate tax exemption law this year. This means that starting January 1, 2011, all estates over one million dollars ($1,000,000.00) may owe a 55% estate tax on the estate value exceeding one million dollars.

At an estate tax exemption of one million dollars, the USDA projects that as many as 1 out of every 10 estates with farmland will owe estate tax in 2011. Farm estates are exceptionally vulnerable to the one million dollar limit due to the rapidly rising price of farmland, coupled with the high cost of the equipment needed to run a farm. Further, life insurance benefits can unexpectedly increase the size of estates for people who never considered themselves millionaires.

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<u>How we got here</u>

As we all know from the headlines, the estate tax was totally repealed in 2010 after ten years of gradual decreases. In spite of the projections of

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Huge Increase In Section 179 Expensing And The Return Of Bonus Depreciation

On September 27, 2010, President Obama signed the Small Business Jobs Act (SBJA). In addition to providing incentives for small businesses, the SBJA extended bonus depreciation for 2010 and raised the Section 179 expensing limits for the years 2010 and 2011 to encourage continued spending and to stimulate the economy.

Under the SBJA, qualifying businesses can now expense up to

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IRS Regulations to Eliminate Paper Federal Tax Deposit Coupons

The IRS has issued proposed regulations that will prevent small businesses and employers from using Federal Tax Deposit Coupons ("paper coupons") to pay depository taxes beginning January 1, 2011. Depository taxes affected include payroll taxes, corporate income taxes, corporate estimates, excise taxes, and other similar taxes.

Beginning January 1, 2011, banks will no longer accept and process checks that accompany paper coupons. Therefore, most taxpayers must electronically pay depository taxes through the IRS' Electronic Federal Tax Payment System ("EFTPS").

To enroll for EFTPS, taxpayers should visit www.eftps.com and submit information that includes their name, address, Tax Identification Number, and bank account and routing number. Once the taxpayer has enrolled, they will make future payments electronically through the website. For customer service information on EFTPS, call 1-800-555-4477.

If you have any additional questions, please feel free to contact one of our attorneys to obtain more information.

By Kyle Marcum

Medicare Contribution Tax Imposed on Unearned Income of High Income Taxpayers in 2013

For tax years beginning in 2013, a Medicare contribution tax will be imposed on the investment income of high-income individuals for the first time ever. This tax also applies to trusts and estates albeit with slightly different rules.

The tax is not imposed on business entities themselves, but affects the "investment income" that these entities pass to their owners (i.e., members of LLCs and shareholders of S Corporations).

Who is affected

The tax is imposed on all, or a portion of, the net "investment income" of those married filing jointly with modified adjusted gross income ("MAGI") in excess of $250,000, and single filers with MAGI in excess of $200,000. MAGI is a taxpayer's adjusted gross income with the add-back of any foreign earned income which was excluded from gross income.

"Investment income" means gross income from interest, dividends, annuities, royalties, rents, capital gains, and business income earned through businesses for which the taxpayer is a passive owner. Additionally, any income earned on the investment of the working capital of a trade or business is treated as investment income, even if the taxpayer materially participates in such trade or business.

To calculate net investment income, any expenses incurred in earning the investment income are deducted from investment income.

The following are not included in the net investment income calculation: tax-exempt bond interest, veterans' benefits, gain from the sale of a principal residence (if excluded from gross income), and distributions from qualified retirement plans and IRAs. Qualified retirement plans and IRAs are now an even more attractive investment due the exemption of qualified distributions from the new Medicare contribution tax.

How the tax is calculated

For those married filing jointly with MAGI in excess of $250,000 and those filing singly with MAGI in excess of $200,000, the tax imposed is 3.8% of the lesser of: (1) net investment income, or (2) the excess of MAGI over $250,000 for those married filing jointly or $200,000 for those filing singly. For example, a single taxpayer with $50,000 of net investment income and an MAGI of $225,000 will be liable for the Medicare contribution tax on $25,000 of net investment income, because that is the amount by which his net investment income exceeds the $200,000 threshold.

Those paying the Medicare contribution tax on net investment income are not allowed a deduction for such payment in computing their Federal income tax liabilities.

By Chris Juffer

The Iowa Capital Gain Exclusion

When considering the possibility of selling the equipment or real estate of a business, the tax impact of the sale is usually a primary concern. For those who have been in their business for an extended period, Iowa may allow a seller to exclude the capital gain income from their Iowa taxes.

There are two instances when the exclusion may apply:

(1) The first is the sale of real estate used in a trade or business.

(2) The second is for certain business property when selling substantially all the personal property or service of the business itself. In this situation, "substantially all" means more than 90% of the fair market value of the assets of the business.

Thus, one can sell a portion of land and receive the exclusion, but would need to essentially sell the whole business to receive the other exclusion.

A sale in either of the two instances requires the seller to have owned the property or, in the case of a business, the business itself for at least ten years immediately before the sale and have materially participated in the business for ten years. For this reason, many refer to this as the "ten and ten exclusion."

Of course, there are exceptions and special requirements to the general rule stated above. One big exception is that Subchapter C corporations are not allowed the exclusion. Sales of breeding stock and timber also have some special requirements. However, when it comes to the "ten and ten" portion of the rule, there are a number of instances where the actual amount of time holding the property or materially participating in the property may be less than ten years. These instances may include how one acquired the property (i.e., gift or inheritance), when the business owner retires, or whether it is sold to a lineal descendent (non-real estate only).

If you are considering the sale of your business, please let us know and we can help determine if you are eligible for an Iowa tax exclusion to any capital gain income.

The Iowa Dept. of Revenue provides helpful flowcharts available at: http://www.iowa.gov/tax/forms/capgains.html

By Lee Rankin

(Small Business Jobs Act, continued from page 1)

$500,000.00 of Section 179 property for tax years beginning in 2010 and 2011. Without the SBJA, the expensing limit for Section 179 property would have been $250,000.00 for 2010 and $25,000.00 for 2011. Currently, the expensing limit for Section 179 will drop back down to $25,000.00 for tax years beginning in 2012.

The $500,000.00 amount provided under the SBJA is reduced, if the cost of all Section 179 property placed in service by the taxpayer during the tax year exceeds $2,000,000.00.

Bonus Depreciation

Under the SBJA Congress also reinstated 50% bonus depreciation for 2010. Bonus depreciation in 2010 has the same requirements as in 2009. To qualify for the 50% bonus depreciation, the property must:

a. Be new property (not used). It must meet the "original use" test;

b. Be acquired and placed in service during the 2010 tax year;

c. Have a "recovery class period" of 20 years or less.

Up to $500,000 in farm or business equipment purchased in 2010 or 2011 can be expensed immediately under the new, higher Section 179 deduction limits.

If a taxpayer does not want to utilize the 50% bonus depreciation, then the taxpayer must make an election on their tax return.

Please note that Iowa did not adopt additional 50% bonus depreciation for assets placed in service in the 2010 tax year, nor did it couple with the federal law allowing Section 179 expensing of $500,000.00. Thus, taxpayers who claim these deductions on their 2010 federal tax return will need to adjust their Iowa returns for the disallowed depreciation or Section 179 expensing.

Please contact your tax advisor to see how these law changes will affect your tax liability for 2010.

By Lonny L. Kolln II

Estate tax (Continued from page 1)

innumerable pundits and observers that this repeal would never happen, Congress was ultimately unable to find an acceptable alternative to the repeal and the estate tax was allowed to expire on December 31, 2009.

While this repeal was a victory for those opposed to the idea of a "death tax," this victory may be short lived due to the fact that the estate tax is scheduled to return on January 1, 2011 at a higher rate (55%!) and affecting estates over $1 million. This tax rate will be a higher rate affecting a lower exemption amount than at any time since 2001.

Planning opportunities

Fortunately, there are several techniques available to gradually transfer farmland and life insurance policies out of an estate, while minimizing the disruption to an ongoing farming operation. Federal law allows a $13,000.00-per-year gift per recipient without paying any federal gift tax, and these gifts can be made of units of an LLC or shares of a corporation. A properly planned estate will use these strategies to ensure that these gifts do not cause unintended problems or expose the farming operation to unnecessary risks as a result of the gifting. If started early enough, gifting can reduce or eliminate estate tax liability.

> *While $1 million sounds like a lot of money, rising farmland values and life insurance benefits can unexpectedly create posthumous "millionaires."*

When facing a potential 55% tax, a small amount of preparation can save your family from paying a huge amount of unnecessary tax. Please do not hesitate to contact our office if you would like more information.

By Frank W. Pechacek, Jr.

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