SUSAN S. LEWIS, LTD.
CERTIFIED PUBLIC ACCOUNTANTS & FINANCIAL PLANNERS
1064 104TH Street, Naperville, Illinois 60564
(630) 548-9600 FAX: (630) 548-9604
www.lewiscpa.us

Inside this issue

Tax & Business letter
SUMMER 2010

Health care reform legislation includes significant tax changes

The new health care legislation includes sweeping changes for both individuals and businesses. The two laws, the *Patient Protection and Affordable Care Act of 2010* and the *Health Care and Education Reconciliation Act of 2010*, encourage universal health insurance coverage through options such as employer plans, state-operated exchanges, and private plans. Here are highlights of tax-related provisions included in these laws.

Insurance coverage

Small businesses. Starting this year, a small business with fewer than 25 employees and average annual wages of less than $50,000 may use a tax credit to partially offset the cost of employer-provided health insurance. The full credit is available to a business with ten or fewer employees and average annual wages of no more than $25,000 per employee.

Individual coverage. Starting in 2014, an individual who doesn't obtain at least "minimum essential coverage" may be assessed a nondeductible tax penalty. The monthly penalty is calculated using a percentage of the taxpayer's income or a flat dollar amount.

Employer coverage. Beginning in 2014, an employer with at least 50 full-time employees may be assessed a nondeductible tax penalty if it doesn't offer minimum essential coverage.

Tax on high-incomers

Medicare tax. Currently, the 1.45% Medicare tax applies to earned income like wages. Starting in 2013, two additional Medicare taxes may be imposed on high-income taxpayers:

- A 0.9% Medicare surtax for joint filers on earned income above $250,000 ($200,000 for single filers).
- A 3.8% Medicare tax on "net investment income" for joint filers with a modified adjusted gross income above $250,000 ($200,000 for single filers).

Net investment income includes "unearned income" such as interest, dividends, royalties, rents, gains from dispositions of property not used in an active trade or business, and passive activity income (but not distributions from qualified retirement plans and IRAs).

Other tax changes

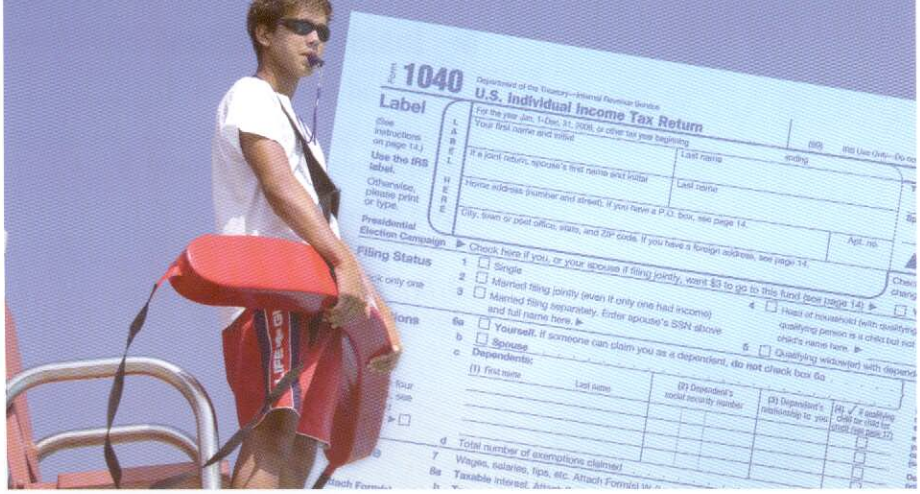
Adoption credit. The adoption credit is increased to $13,170 for 2010 (from $12,170) and extended through 2011. The credit is also made refundable.

Information reporting. Effective for 2011, employers must report the value of health insurance coverage on each employee's Form W-2. Effective for 2012, a business must file information returns for annual payments totaling $600 or more made to corporations (other than tax-exempt entities).

Medical deductions. Currently, you can deduct unreimbursed medical expenses in excess of 7.5% of adjusted gross income. Starting in 2013, the floor will be raised to 10%. Exception: Prior to 2017, individuals who are 65 or older are exempt from this increase. They may continue to use the 7.5% threshold.

Flexible spending accounts (FSAs). Beginning in 2013, the maximum

(continued on page 2)



Taxes and summer jobs

Is your child looking for a job this summer? If so, you both may have questions about taxes. Here are three common concerns.

Is a tax return required? The answer depends on several factors, including the total amount of income received. For instance, if wages are the only source of income, your child can generally earn up to $5,700 during 2010 before a federal tax return is necessary.

However, unless your child can claim an exemption from withholding, a return may be required even when wages earned are lower than the filing requirement. That's because filing is the only way to claim a refund of overpaid taxes.

In addition, self-employment income, tips, and interest, dividends, and stock sales can affect the filing requirement.

Can my child open an IRA? Anyone under age 70½ who has earned income can contribute to a traditional IRA. There's no age restriction for Roth accounts, though the amount of the contribution phases out at higher income levels (starting at $105,000 for single individuals in 2010).

If your child will receive a federal income tax refund, you could choose to have it deposited directly into an IRA. As an alternative, you can provide the funds for an IRA and let your child keep the refund.

The maximum standard contribution for 2010 is $5,000.

Are there any tax breaks if my child works for me? You can take a business tax deduction when you pay a reasonable wage for work your child performs in your business. If your business is a sole proprietorship or a partnership you and your spouse operate, and your child is under age 18, you don't have to pay social security, Medicare, or federal unemployment taxes. The child's wages are subject to income taxes.

If you have other questions about the tax implications of a summer job, give us a call. ◆

Health care reform (continued from page 1)

amount that may be contributed to a health care FSA will be limited to $2,500.

Penalty tax. Starting next year, the additional tax on nonqualified distributions from health savings accounts increases from 10% to 20%. For nonqualified distributions from an Archer medical savings account, the additional tax increases from 15% to 20%.

The health care reform legislation will affect every taxpayer and every business. Contact us for more information on how the new rules will affect you. ◆

IRS TAX NOTES

IRS audit activity

A three-year random audit program started by the IRS in 2007 will now be continued indefinitely. These random audits of individual tax returns are used by the IRS to collect noncompliance data for adjusting general audit formulas and updating tax gap estimates.

Tax returns claiming the homebuyer tax credit are another audit target. The IRS expects to open 200,000 audits by the end of 2010 to address potential fraud in claiming the homebuyer credit. The Service will also be monitoring the recapture of the credit by checking public databases of real estate sales. Generally, those who sell a home within three years of taking the tax credit must pay it back.

New hire Form W-11

Employers may qualify for an exemption from social security payroll taxes on qualified workers hired after February 3, 2010, and before January 1, 2011.

The IRS has released Form W-11 to be used to verify worker eligibility for this tax exemption. The form is to be filled out by the new hire, certifying under penalty of perjury that he or she was either unemployed or worked less than a total of 40 hours during the 60 days prior to taking the current job. The W-11 forms are not to be filed with the IRS, but rather retained in the employer's payroll records.

2010 HSA limits

Health savings account (HSA) contribution limits have been announced by the IRS. The limit for individuals with a high-deductible health plan is $3,050 for 2010; for family coverage, the limit is $6,150. An additional $1,000 contribution can be made by those who are 55 years old or older. ◆

Should you convert your regular IRA to a Roth?

For the first time ever, high-income taxpayers are eligible to convert a traditional IRA to a Roth IRA. Prior to 2010, you could not convert to a Roth in a year in which your modified adjusted gross income exceeded $100,000. But this limit was removed by a 2006 tax law change that took effect January 1, 2010. So the question of the year is, should you do a conversion? There are numerous factors to take into account.

First, you must understand the critical differences between the two IRAs. With a traditional IRA, contributions may be partially or wholly tax-deductible, but distributions are generally taxable at ordinary income rates. In contrast, contributions to a Roth IRA are never tax-deductible, but qualified distributions from a Roth in existence at least five years are completely exempt from tax. Qualified distributions are those made after age 59½, due to death or disability, or used for first-time homebuyer expenses (lifetime limit of $10,000). Also, unlike a traditional IRA, mandatory distributions after age 70½ aren't required for a Roth.

Thus, by converting to a Roth, you pay an up-front tax on the current value of IRA assets in exchange for future tax-free withdrawals. For a conversion occurring in 2010, you can choose to split the taxable income evenly over the following two years, 2011 and 2012.

In analyzing whether you should convert or not, consider the following points:

- If you have to pay all or part of the conversion tax with funds in your traditional IRA, the benefit of the conversion is diluted. The account can grow even larger if you have other resources to pay the required tax.
- Consider state income tax implications. In some situations, the combination of federal and state income tax liability could discourage a conversion.
- Both your current income tax rate and your projected income tax rate can affect your decision. For instance, if you're now in a high tax bracket but expect to be in a much lower bracket in retirement, you may be less inclined to convert from a traditional IRA. Conversely, the prospect of rising tax rates generally favor a Roth conversion.
- Spreading out the tax liability for a 2010 conversion over the next two years may not be the right choice in your situation.
- Converting to a Roth could trigger alternative minimum tax (AMT) liability.
- Be aware that you don't have to convert the entire balance in an IRA or all your IRAs. Partial conversions are permitted. Finally, you have the ability to "recharacterize" a Roth back into a traditional IRA if it suits your needs.

Call us if you would like to discuss the suitability of a Roth conversion in your personal situation. ◆

Two prior IRA rules are still in effect for 2010

RULE #1

Note that while converting a traditional IRA to a Roth IRA is now open to everyone, regardless of income, contributing to a Roth IRA is still not allowed for higher-income taxpayers. For 2010, Roth IRA eligibility phases out for singles once income reaches $105,000 and for joint filers once income reaches $167,000.

RULE #2

For 2010, annual minimum distributions from most retirement plans (except for Roth IRAs) are once again required for those aged 70½ and older. In 2009, these required minimum distributions (RMDs) were suspended. 2010 required distributions must be taken by December 31, 2010. Taxpayers who turn 70½ in 2010 may choose to delay taking their first distribution until April 1, 2011.

For additional information or assistance with your IRA decisions, give us a call. ◆

SUSAN S. LEWIS, LTD.
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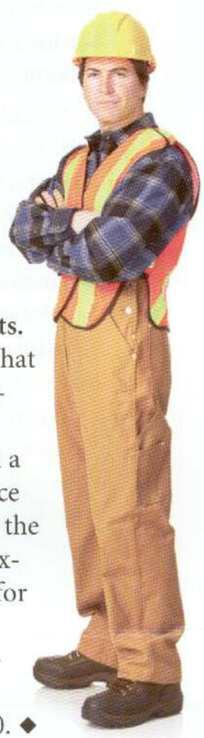
HIRE Act offers temporary tax breaks for businesses

The *Hiring Incentives to Restore Employment Act (HIRE Act)*, signed by President Obama on March 18, 2010, includes temporary tax breaks for businesses that hire workers who have been unemployed for at least 60 days, and it extends for one year the higher expensing limit for business equipment purchases.

Hiring incentives. Employers can receive an exemption from social security payroll taxes for every qualified worker hired after February 3, 2010, and before January 1, 2011. For new hires kept on the payroll for at least 52 weeks, employers may qualify for a tax credit for each retained worker of the lesser of $1,000 or 6.2% of wages paid during the 52-week period.

Increased expensing limits. The 2009 maximum amount that could be expensed for the purchase of new or used business equipment was $250,000, with a dollar-for-dollar reduction once total equipment purchases for the year exceeded $800,000. The expensing limit fell to $134,000 for 2010, with phase-out set at $530,000. The *HIRE Act* retroactively reinstates the higher 2009 expensing limits for 2010. ◆



Tax Calendar — Summer 2010

June 15 – Second quarter 2010 individual estimated tax is due.

June 15 – Second quarter 2010 estimated tax is due for calendar-year corporations.

August 2 – 2009 retirement and employee benefit plan returns are due for calendar-year plans.

September 15 – Third quarter 2010 individual estimated tax is due.

September 15 – Third quarter 2010 estimated tax is due for calendar-year corporations.

September 15 – Deadline for filing 2009 calendar-year tax returns for corporations with extensions of the March 15 deadline.

September 15 – Deadline for filing 2009 partnership returns with extensions of the April 15 deadline. ◆

NOTE: *This newsletter is issued quarterly to provide you with an informative summary of current business, financial, and tax planning news and opportunities. Do not apply this general information to your specific situation without additional details. Be aware that the tax laws contain varying effective dates and numerous limitations and exceptions that cannot be summarized easily. For details and guidance in applying the tax rules to your individual circumstances, please contact us.*

We appreciate your business. Please call any time we can be of assistance to you in your tax, financial, or business affairs.

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