



## Correcting tax return errors

Once you've filed your 2009 tax return, you probably don't want to think about last year's taxes again. But what if you discover you made a mistake on your return? You might have overlooked a big deduction. You might find a missing receipt or come across a dividend check that you didn't report. Don't worry. You can correct the mistake by filing an amended return.

*Sometimes it's not a mistake that's the issue.* For example, you might find out that stock you own became worthless in an earlier year. You have to claim the loss in the year the stock became worthless, so you file an amended return for that year.

If you're an individual, an amended return is filed on Form 1040X. Corporations use Form 1120X.

As a general rule, you have three years to file an amended return, or two years from when you paid the tax, whichever is later. You may have longer if you're carrying back business losses or claiming a worthless security. You'll have to file a separate form for each year that has changed.

*An amended tax return may result in either a refund or a balance due.* In deciding whether or not to file an amended return, you should take into account the amount of money involved.

If you've discovered an error or missing information on one of your tax returns, give us a call. We can review your prior tax returns to help you determine the need for filing an amended return. ♦

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# clientalert

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## Health care legislation includes tax changes over the coming decade

**N**ew federal tax credits, changes to existing credits, simplified benefit plans, and modifications to existing health plans. The two health care reform bills, signed into law in March 2010, feature all of these – and more. Some of the rules are effective immediately, while others come into play in future years.

Here are highlights of provisions that will affect your personal and business income tax returns during 2010 and 2011.

### ■ Small business credit

You may be able to claim a new federal credit on your 2010 tax return when you pay at least half the cost of health care premiums for your employees. Generally, the nonrefundable credit can be carried back one year and forward 20 years, and will reduce your tax bill dollar-for-dollar.

The amount of the credit, which can be as much as 35% of your qualified premiums, varies

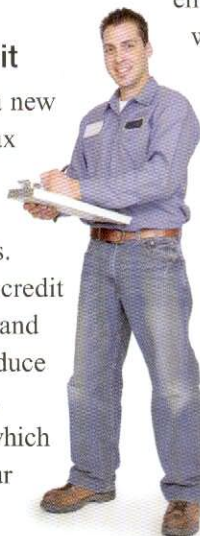
based on the number of employees you have and the average annual wages of those employees.

In general, the credit is available to employers that have no more than 25 full-time equivalent (FTE) employees paying average annual wages of no more than \$50,000 per employee. Eligibility is based partially on FTEs, not the number of employees; therefore, an employer with fewer than 50 half-time workers could qualify for the credit.

The maximum credit goes to those employers with ten or fewer employees who pay annual average wages of \$25,000 or less.

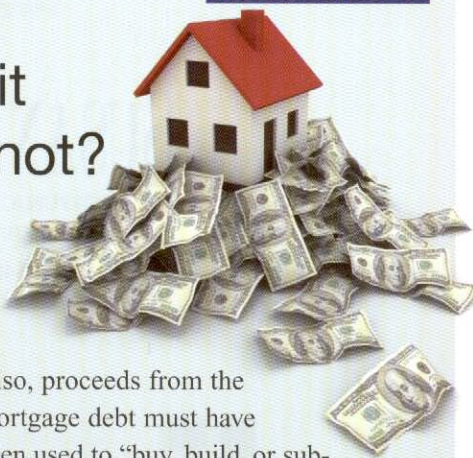
When you're self-employed, either as a partner or a sole proprietor, or if you own more than 2% of an S corporation, you're not considered an employee for purposes of the credit.

Tax-exempt organizations can use the credit to offset payroll tax liability (up to 25% of qualified premiums paid).



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## Cancelled debt: Is it taxable income or not?



**W**hew! You've finally negotiated a deal with the credit card company, and they've agreed to cancel part of your outstanding debt balance. Now maybe you can get on with your life and leave those pesky bill collectors behind.

Unfortunately, your successful negotiations may have given rise to something less comforting: a hefty tax bill. That's because, as a general rule, the IRS considers cancelled debt to be taxable income. If you owe \$10,000, for example, and a lender agrees to reduce your outstanding loan balance to \$7,000, taxable income of \$3,000 has been generated. That's true whether or not a single penny shows up in your bank account. In fact, lenders are required by law to report – to both the IRS and the debtor – cancellation of debt that exceeds \$600. Such "income" is disclosed on IRS Form 1099-C, which specifies the amount to be reported on your federal tax return.

Fortunately, the tax code also provides exceptions for certain types of debt forgiveness, including the following:

▶ **Mortgage forgiveness.** Among other things, the recently passed *Mortgage Forgiveness Debt Relief Act* allows taxpayers who lose their homes through foreclosure to exclude up to \$2 million of cancelled mortgage debt from income. It's important, however, to read the fine print. The exclusion doesn't apply to mortgages on second homes or investment property, for example.

Also, proceeds from the mortgage debt must have been used to "buy, build, or substantially improve" your principal residence. Paying off credit cards with a home equity loan probably doesn't qualify.

▶ **Insolvency.** If your liabilities exceed your assets – if you're caught, for example, in the "under water" situation in which your mortgage balance is greater than the market value of your house – you may be able to exclude some cancelled debt from your income.

▶ **Bankruptcy.** Generally speaking, debts discharged in bankruptcy don't generate income for federal tax purposes.

▶ **Student loans.** To attract workers to certain occupations – for example, doctors, nurses, or teachers who serve in rural districts – employers may arrange to have college debt reduced or paid off. Under certain circumstances, such debt reductions may be excluded from taxable income.

Whether or not your situation falls into one of the above categories, be sure to keep any IRS forms you receive from creditors. Remember, the IRS is also getting a copy. If you fail to report the proper amount of income on your federal tax return, you may regret it later. And be sure to compare amounts on loan statements with similar numbers on the IRS forms. Lenders make mistakes too.

If you'd like additional information about income from cancelled debt, give us a call. ♦

## Health care legislation (continued from page 1)

### ■ Adoption credit

Adoptive families can claim a credit for adoption expenses during 2010 and 2011. The credit is increased to \$13,170 and is now refundable, meaning you get money back even if you owe no tax.

The amount you can claim depends on modified adjusted gross income, so you may want to consider midyear tax planning to maximize the benefit.

### ■ Simplified benefit plans

Starting next year, a new "safe harbor" plan will be available that will allow you to more easily offer tax-free benefits to your employees.

Generally, you'll be able to set up a "SIMPLE cafeteria plan" when you have no more than 100 employees who are all eligible to participate and you make a minimum contribution to the plan for those employees.

Cafeteria plans allow your employees to select from a variety of benefits and pay for them with pre-tax dollars. The plans also offer tax savings for your business.



### ■ Changes to health plans

Beginning January 1, 2011, your costs for over-the-counter drugs will no longer qualify for tax-free reimbursement from flexible spending arrangements, health reimbursement arrangements, health savings accounts, and medical savings accounts. Depending on your medical needs and plan balance, you may want to schedule purchases of non-prescription drugs before the end of 2010.

The health care reform laws include other new programs, reporting requirements, and penalties that will demand a renewed focus on tax planning and recordkeeping. For guidance in your planning, give us a call. ♦

## New Roth IRA conversion rules may upend conventional tax wisdom

**N**ow that Congress has lifted the \$100,000 income limitation for converting traditional IRAs to Roth IRAs, you might find yourself confronted with an important question: Do I convert or not? While there are no pat answers, certain critical factors can influence your decision.

As a review, Roth IRAs differ from traditional IRAs in that contributions to a Roth are not tax-deductible. But qualified withdrawals are not included in taxable income, and withdrawals are not required when you reach age 70½. Therefore, a Roth IRA can be a smart way to set aside after-tax money and accumulate tax-free earnings.

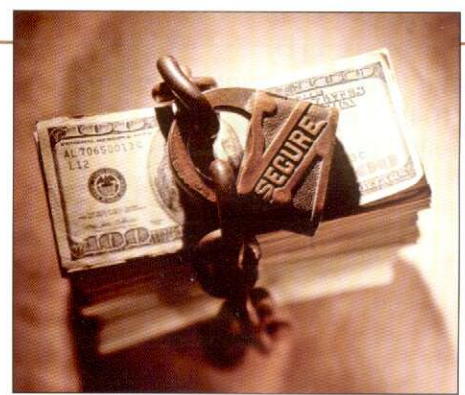
Because withdrawals from a traditional IRA are taxable, any amount you convert to a Roth is likewise taxable. At first blush, such a move seems contrary to conventional tax planning wisdom. Usually, you want to defer taxes as long as possible. But there

are several reasons why you might want to consider a conversion.

First, making the switch now will “lock in” your tax bill based on current values. Qualifying withdrawals from this point forward will be entirely tax-free. For those who are many years from retirement, this can be particularly advantageous. And even if you never plan to use your IRA for retirement funding, converting now will relieve your heirs of the income tax burden associated with a traditional IRA.

Another reason to convert is to take advantage of today’s historically low tax rates. If you believe that taxes will go up in the future – and many do – this might be an opportune time to make the conversion. And you don’t have to pay the tax on your 2010 tax return. You can choose to split the income equally between your 2011 and 2012 returns.

When is a conversion not a good idea? It probably doesn’t make sense unless you have cash to pay the taxes



from sources outside of the IRA. Shaving off part of the IRA to pay the taxes not only might harm the investment performance of the account, you could be subject to the 10% penalty for early withdrawal if you are under age 59½. Also, if you are close to retirement, a conversion is probably not desirable unless you think that your tax bracket will be higher after you retire than it is now.

If you convert a regular IRA to a Roth IRA and decide it was not a good idea, you can switch back to a regular IRA. You have until October 15 of the year following the conversion to switch back without a penalty.

A smart Roth conversion is a delicate balancing act between retirement goals, personal tax rates, and investment assumptions. For guidance in making this important decision, contact our office today. ♦

## **business alert**

### *HIRE Act* includes temporary tax breaks for businesses

The *Hiring Incentives to Restore Employment Act (HIRE Act)* was signed by President Obama on March 18. The law creates new tax breaks for employing certain workers, and it extends the higher Section 179 “expensing” allowance for another year.

Under this law, an employer who hires qualified unemployed workers may be exempt from paying the 6.2% social security tax on their



wages. The new hire must begin employment after February 3, 2010, and before January 1, 2011.

To qualify, a worker cannot have been employed for more than 40 hours during the previous 60 days ending on the start date. The exemption applies to both part-time and full-time workers.

In addition, an employer may claim tax credits for retaining these workers for at least 52 consecutive weeks. Each

credit equals the lesser of \$1,000 or 6.2% of the employee’s wages paid during the 52-week period.

**Expensing limit.** The law also extends the maximum \$250,000 deduction for business property placed in service in 2010. Without this extension, the 2010 deduction would have been limited to \$134,000. The law keeps the \$800,000 phase-out level in place. The *HIRE Act* did not extend “bonus depreciation” which was in effect in 2009. ♦

## what the is up to

### IRS issues vehicle info

The IRS has released the annual depreciation limits for business vehicles first placed in service during 2010.

For passenger automobiles, the deduction limits for the first three years are \$3,060, \$4,900, and \$2,950, respectively, and \$1,775 for each succeeding year. For trucks and vans, the deduction limits for the first three years are \$3,160, \$5,100, and \$3,050, respectively, and \$1,875 for each succeeding year.

Another IRS announcement related to business vehicles: Because two-wheeled vehicles are being used more and more for business travel, the IRS may soon provide a standard mileage rate for the business use of motorcycles.

### 2010 HSA limits released

The IRS recently provided the inflation-adjusted contribution limits for health savings accounts (HSAs) for 2010. HSAs allow taxpayers with high-

deductible health insurance plans to set aside pretax dollars that can be withdrawn tax-free to pay unreimbursed medical expenses. The 2010 contribution limit for individuals is \$3,050; the limit for family coverage is \$6,150. A catch-up contribution of an additional \$1,000 is permitted for individuals who are 55 or older.

### New form for new hires

A new IRS form is now available for employers to claim the payroll tax exemption for hiring unemployed workers. Form W-11 (Hiring Incentives to Restore Employment Act Employee Affidavit) is to be filled out by the new hire, certifying under penalties of perjury that he or she was either unemployed or worked fewer than a total of 40 hours during the 60 days prior to taking the current job. The W-11 forms are not filed with the IRS; the employer must retain them along with other payroll records. ♦



#### ■ June 15

Due date for second installment of 2010 individual estimated tax.

#### ■ August 2

Due date for filing 2009 retirement or employee benefit plan returns (5500 series) for plans on a calendar year.

#### ■ September 15

Due date for third installment of 2010 individual estimated tax.

#### ■ 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. ♦

*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.*