



# tax & business letter

## IRS TAX NOTES

### IRS audits more returns

The IRS recently released data showing an increase in taxpayer audits during fiscal year 2007 (which ended September 30, 2007).

The 2007 IRS audit rate for individual returns reporting income of \$1 million or more increased 84% over 2006. The total number of individual returns audited in 2007 for all income levels increased by 7% to 1.3 million, the highest number of audits since 1998.

Business audits for 2007 also increased,

up 14% from the prior year. The audit focus was on partnerships and S corporations, with audits of these pass-through entities increasing 26% in 2007. Audits of large corporations decreased slightly in 2007, but audits of mid-sized corporations increased.

The IRS filed 3.8 million levies and about 700,000 liens during 2007. IRS enforcement activities produced \$59.2 billion in revenue during 2007, compared with \$48.7 billion in 2006 and \$34.1 billion in 2002.

### 2008 HSA limits increase

Health Savings Accounts (HSAs) allow taxpayers with high-deductible health insurance to set aside tax-deductible dollars that can be used tax-free to pay unreimbursed medical expenses. The amount that can be contributed each year to an HSA is adjusted annually for inflation. The limits announced by the IRS for 2008 are \$2,900 for an individual and \$5,800 for a family. Those 55 years old or older may contribute an additional \$900 for 2008. ♦

*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 and/or professional assistance.*



**March 17** – Deadline for calendar-year corporations to elect S corporation status for 2008.

**March 17** – Deadline for filing 2007 tax returns for calendar-year corporations.

**April 1** – Deadline for taking your first distribution from regular IRAs if you turned 70½ in 2007. Unless you're still working, this deadline also applies to your other retirement accounts (except for Roth IRAs).

**April 15** – Deadline for filing 2007 individual tax returns.

**April 15** – Deadline for filing 2007 partnership returns.

**April 15** – Deadline for filing 2007 gift tax returns.

**April 15** – Deadline for making your 2007 IRA contribution.

**April 15** – First installment of 2008 individual estimated tax is due.

**June 16** – Second installment of 2008 individual estimated tax is due. ♦

## Two new tax laws signed at year-end 2007

Congress passed two new tax laws in a flurry of year-end 2007 activity. The laws, which include an alternative minimum tax (AMT) "patch" and mortgage relief for homeowners, will affect a wide range of taxpayers. But other proposed tax legislation was put on the shelf, at least temporarily. Here's a brief summary of the key changes in the two new laws.

### AMT patch

Under the *Tax Increase Prevention Act of 2007*, the AMT exemption amounts for 2007 are bumped up from their 2006 levels. Without this change, the amounts were scheduled to revert to low levels in effect back in 2001. The new law arrived in time to save 21 million taxpayers from the AMT (although it may cause refund delays).

Of course, the latest AMT relief is only a temporary fix. This is likely to be a political hot potato as the Presidential election approaches.

### Mortgage debt relief

The *Mortgage Forgiveness Debt Relief Act of 2007* carves out the following tax breaks for homeowners:

- **Debt forgiveness.** Prior to this law, the forgiveness of mortgage debt by a lender generally resulted in taxable income to the taxpayer. The new law allows homeowners to exclude up to \$2 million of certain forgiven mortgage debt from federal taxable income. The exclusion is available for 2007, 2008, and 2009 and applies to foreclosures and renegotiations of qualified mortgages on primary residences. The amount of debt forgiven reduces the basis in the home.

- **Mortgage insurance.** For the first time, taxpayers were permitted a deduction for qualifying mortgage insurance premiums on 2007 returns. The new law extends this deduction for three years – 2008 through 2010.

- **Home-sale exclusion.** You can claim a tax exclusion on the first \$250,000 of gain on the sale of a home you've owned and used as your principal residence for at least two out of the five prior years. The exclusion is \$500,000 for joint filers.

Under prior law, a surviving spouse could benefit from the full \$500,000 exclusion only if he or she sold the home in the year a joint return was filed. Now for post-2007 sales, a surviving spouse may claim the \$500,000 exclusion for sales occurring within two years of the other spouse's death.

### Economic stimulus

On January 24, 2008, President Bush and leaders of the House of Representatives

*(continued on page 2)*

### Early bird tax tips:

As you adjust your investments for 2008, remember that the tax rate on long-term capital gains and certain dividend income drops to zero for taxpayers in the bottom two regular tax brackets (10% and 15%). The zero rate could apply to you if you're single with income below \$32,551 or married with income below \$65,101.

Maximize your retirement plan contributions this year. Be aware that the limit for IRAs increases to \$5,000 this year if you're under age 50 and to \$6,000 if you're 50 or older.

The kiddie tax rules changed again this year. If your child has unearned income over \$1,800 in 2008 and is under age 19 (under age 24 if a full-time student), the kiddie tax could apply.

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## How to get a child started in business

Perhaps you're thinking of helping one of your children get started in business. Since the failure rate for new businesses is high, you need to do whatever you can to increase your child's chances of success. That includes considering three M's: motivation, money, and mentoring.

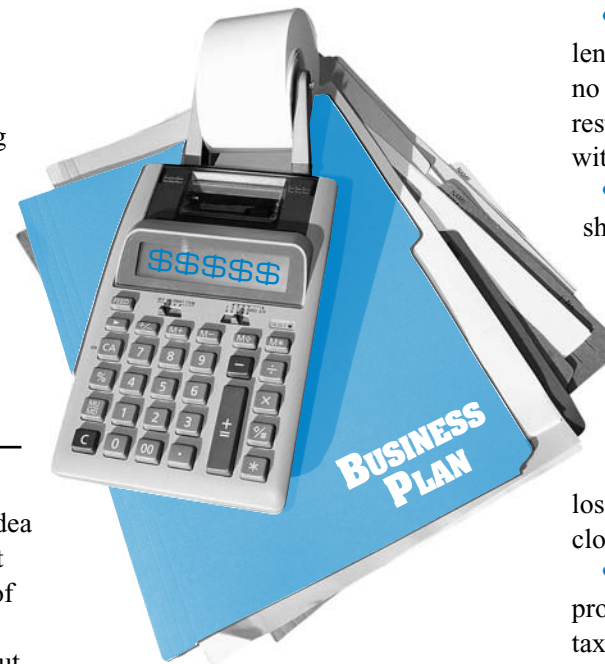
### Motivation

To succeed, your child must be motivated. He or she may like the idea of self-employment but lose interest when confronted with the realities of planning and preparation.

Before involving yourself, find out how much time, thought, and effort your child has already devoted to the proposed business. If the enterprise is no more than an idea, you can suggest approaches to researching the market and determining the resources, knowledge, and skills that will be needed. However, your input should be limited to guidance and ideas. Your child should do the work.

Once your child has completed the necessary groundwork, and if

the project still seems reasonably feasible, you'll be ready to consider the next steps.



### Money

Whether you're making a loan or buying an ownership interest, keep the following guidelines in mind:

- *Never put up more money* than you can comfortably afford to lose.
- *Try not to be the sole source of capital.* Risk is part of the business experience, and your child should have some personal assets at stake. Although loans from outside sources

may also be part of the mix, they should be limited in order to keep the debt service from becoming overwhelming.

- *Set limits.* Make it clear that you'll lend or invest a specific amount and no more. You also may wish to set restrictions on the use of the funds within the business.

- *Put everything in writing.* Loans should be supported by signed notes that stipulate repayment terms and require interest at market rates.

Investments should be supported by partnership agreements, shareholder agreements, or similar documents that describe operating arrangements, profit and loss sharing, buyout provisions, and closing contingencies.

- *Don't forget tax planning.* You probably will want to allocate any taxable income to your child, and you certainly will want to be able to write off your loss if the business goes bad. Proper documentation will be paramount, since the IRS closely scrutinizes family transactions.

### Mentoring

Remember that the primary objective is to give your child business experience. Explain the reasons behind each of your requirements, and make it clear that the child must consider your input as a condition of accepting your money. You should offer advice freely, but let your child make most of the business decisions. Mistakes are part of the learning process.

If you're thinking about helping your child get started in a business, give us a call. We'll be glad to offer guidelines to fit your particular circumstances. ♦

[www.verticaladvisors.com](http://www.verticaladvisors.com)

## Do you owe taxes when you sell online?

Selling items on eBay and other online auction Web sites has become a very popular way to get rid of unwanted household stuff, as well as a way to turn a little profit. Many users have even started full-time businesses auctioning merchandise on the Web. But like any business venture, selling items in the virtual world has tax implications that are all too real.

From a tax standpoint, casual selling on eBay is essentially the same as holding a garage sale. If you sell an item for less than you paid for it, you cannot deduct the "loss." When you sell something for a profit, however, you must report it on your tax return. Long-term gains on the sale of collectibles, such as artwork, antiques, or rare coins, are taxed by as much as 28%.

Profit is the difference between the selling price and your "basis" in the item. In most cases, basis is simply the amount you paid for it. Inherited items generally have a basis equal to their fair market value at the time of receipt. If the basis cannot be documented, it becomes zero, and you pay tax on the entire selling price.

Online selling activity can reach the point where it is deemed to be a business venture. Status as a for-profit

eBay business versus a casual online seller is not clearly defined. Factors considered by the IRS include the amount of time you spend selling online and whether you conduct yourself like other self-employed business owners, such as keeping accounting records and advertising your services.

The good news is that if you are treated as a business, you can deduct expenses related to your selling activity. This can include Internet access fees and home office expenses. You may also be able to deduct travel expenses incurred in searching flea markets and other locations for items to sell. The downside to business status is that profits from selling online may be subject to self-employment tax.

What's more, depending on where you live, you may be required to collect and report local and state sales taxes.

Taxpayers who operate like a business, but rarely show a profit, may be treated as a hobbyist and have their business losses denied. In this scenario,

losses can only be deducted to the extent of gains. Generally, if you show a profit in most years, a few down years should not put you in danger of this label.

Whether you are an infrequent user of online auction sites, or an all-out eBay business owner, you cannot afford to ignore the tax implications of selling online. For the details you need to avoid tax problems, call our office today. ♦



## Need retirement income?

If you own your home and are age 62 or older, one option to increase your retirement income could be a reverse mortgage.

With a traditional mortgage, you borrow a sum of money to purchase a home, then pay off the debt over time. With a reverse mortgage, you receive loan proceeds – as a lump-sum payout, an annuity, a line of credit, or a combination of all three – but make no payments as long as you reside in the property. The loan, with any accrued interest, comes due when you move out or pass away.

To qualify for a reverse mortgage, you need to be at least 62 years old and own the home outright (or have a balance that can be paid off with the loan proceeds). How much you can borrow depends on your age, the home's market value, and interest rates.

- *The downside.* Be aware that there is a downside to a reverse mortgage. Closing costs can be very steep, often over 5% of the home's value. In addition, borrowers may have to purchase mortgage insurance, and they're still on the hook for property taxes and homeowner's insurance.

Federal truth-in-lending laws require lenders to provide information about interest rates, payment terms, and other costs. If you're interested, shop for a reverse mortgage as you would for any other loan. Make sure the basic terms of competing loans are comparable. Then go with the lowest price by comparing interest rates, upfront fees, and other charges. If you need help, give us a call. ♦

### Two new tax laws (continued from page 1)

reached an agreement on a package of tax cuts to stimulate the U.S. economy. Key components of the agreement: tax rebate checks to approximately 117 million Americans and increased depreciation allowances for businesses.

At press time, final legislative details on this stimulus package had yet to be worked out. Congress is also expected to revisit a number of other tax issues in 2008. Stay tuned, and be sure to contact us for the latest information before you make tax-related decisions in 2008. ♦