Winter 2011

O'MALLEY NEWS & VIEWS

Accounting and tax preparation for today

Financial planning for tomorrow

a publication by

O'MALLEY & O'MALLEY, LLP ■ Certified Public Accountants
A Family Business since 1945 ■ CERTIFIED FINANCIAL PLANNER™
AICPA Members ■ Licensed in NJ & PA
Accounting and Tax Preparation for Today ■ Financial Planning for Tomorrow
Website: www.omalleycpa.com ■ E-mail: omalleycpa@comcast.net
3112 Woodhaven Drive ■ Cinnaminson, NJ 08077
Phone (856) 829-9100 ■ Fax (856) 829-4422

IN THIS ISSUE...

In addition to Chuck's "Washington Watch," on page 9 Mariette discusses retirement plans for small businesses. This issue also provides information about the tax laws affecting the preparation of your 2010 tax return, and includes an abbreviated version of The "Bush Tax Cut" Extension from our SPECIAL 2010 YEAR END EDITION, plus the figures subject to annual adjustment, in an easy-to-read **Tax Reference Guide**, see page 5.

■ ■ ■

CLIENTS, FRIENDS & FELLOW PROFESSIONALS – A SPECIAL THANKS!

Our continued success would not be possible without your support and recommendations. ***We are actively looking for new clients - businesses, trusts and/or individuals.*** Your continued confidence and referrals are appreciated. Thank you for giving us the opportunity to serve you and your friends.

Washington Watch

by Charles K. O'Malley, CPA, CFP®

We begin the second decade of the 21st Century with the economy still in recovery mode, the Dow at 11,578 (a ten year net gain of only 790), unemployment around 9.4%, 46 state budgets with deficits, the U.S. debt at $14 trillion and the President's debt commission telling us, we need to cut spending and raise (tax) revenue. Fiscal responsibility appears to be in vogue, but with budget deficits at $100 billion a month, implementation will be difficult.

The current debt ceiling is $14.3 trillion and Congress has not authorized the October 2010 budget. They have passed two continuing resolutions which will keep the government running until March 4, 2011.

It appears that Congress will have to vote on raising the debt ceiling.

With some calling for a government shutdown to force spending reductions and not raise the debt ceiling, it may be a déjà vu moment (Republican controlled house and a Democratic President), such as led to the 1995 government shutdown. The current thinking is not that extreme. A spokesperson for Speaker of the House, John Boehner stated:

> **"…We've been clear all along: Our goal is cutting government spending to help create jobs – not shutting down the government…"**

(continued on page 7)

WHAT'S NEW AT O'MALLEY & O'MALLEY, LLP

Our website, **www.omalleycpa.com**, has again been updated and expanded and now contains an expanded multi-year version of the **Tax Reference Guide** with many of the annually adjusted IRS dollar limitations, plus multiple prior editions of "News & Views" and other informative newsletters.

Mariette has another Irish Setter champion. CH. Ramblin' Red National Dreams (a Gypsy great-granddaughter), was Best of Winners at the Annual Irish Setter National and accumulated her final championship points at the three day Fall Irish Setter Specialty and also won the Gypsy Memorial Trophy. Our mascot, Champion Ramblin' Red Chernobog (Gypsy's only son) has finally retired from the show ring, but "Charles" is still working his day job as our official four-legged office greeter. He is looking forward to seeing you soon.

IMPORTANT DUE DATES

March 15th - Corporate Tax Returns (two & a half months after their year end)

April 18th - Individual, Partnership & LLC Returns

Estate and Trust returns (three and a half months after their year end)

First Individual Estimate Payment

A six month filing extension is generally available for individual and corporation income tax returns, but partnership, LLC, estate and trust returns that supply K-1 reports to participants can only get a five month extension, now making the final extended due date September 15th. Taxes, however, must be paid by the original due date in order to avoid penalties and interest.

Make sure your Social Security number is properly entered on all of your tax returns and any checks for tax payments.

■ ■ ■

Estimated Tax Payments

For 2011, individuals and corporations must pay at least 90% of the current year's tax, or 100% of the prior year's tax. If your Adjusted Gross Income (AGI) is over $150,000, you must pay 110%, some limited exceptions apply.

■ ■ ■

Individual Tax Rates

The six graduated tax rate brackets applied to taxable income after subtracting deductions and exemptions are listed at **www.omalleycpa.com**, tax info page, and included in The "Bush Tax Cut" Extension part of this newsletter. See page 6.

■ ■ ■

Alternative Minimum Tax

Another temporary fix for 2010 and 2011 will allow millions of taxpayers to again avoid this costly tax trap. The exempt income amounts were increased to $72,450 for joint filers (2011 is $74,450) and $47,450 for single filers (2011 is $48,450). Without this temporary fix, the limits would have been $45,000 for joint filers and $33,750 for single filers. This temporary fix may allow those who escaped AMT last year to avoid it again in 2010 and 2011, but if AMT got you in 2009, then it will probably get you again.

New IRS Regulations and Substantiation Test

2010 is the first year that the Internal Revenue Service will require all paid tax preparers to be registered and have a Preparer Tax Identification Number, PTIN. We welcome this registration and its mandated education requirements. Your O'Malley & O'Malley, LLP tax advisers (all State licensed CPA's and PA's) maintain a high ethical standard, stay up-to-date by attending Continuing Professional Education courses and through the years have performed their tax preparation services in accordance with Internal Revenue regulations and now each of them have been assigned a PTIN.

The regulations have increased the potential for tax preparation penalties in cases where the Internal Revenue deems the preparer aided the taxpayer in avoiding taxes, thus the reason for the PTIN. This year, we will again be asking clients to sign a tax return preparation engagement letter. Please discuss it with your tax adviser; we want you to be comfortable with it before you sign your tax return.

■ ■ ■

Page 1 Deductions from Total Income to Determine AGI

They're all allowed again, even teacher's expenses ($250 limit per taxpayer – with the excess allowed as an itemized deduction), plus tuition and fees and all of the other prior year deductions, they were all extended in December.

■ ■ ■

Itemized Deductions

Your standard vs. itemized deductions should always be compared. You may deduct the greater figure.

Millions of taxpayers miss this valuable deduction every year. You get to make this choice each year. Thus, by doubling up on deductions (pay ahead on real estate taxes, charitable contributions, etc.) in one year, you can increase your itemized deductions for that year and then use the standard deduction the following year.

The following items are deductible as itemized deductions on your federal income tax return:

- Medical expenses paid by you, including dental costs, eyeglasses, health insurance, (long-term care insurance premiums are considered medical expenses, but there is a limit to the yearly deduction, $3,290 for 2010 and $3,390 for 2011 for individuals between 61 and 70; and $4,110 for 2010 and $4,240 for 2011 for those over 70), which exceeds 7.5% of your AGI. If you are self-employed, 100% of your health insurance premium, including long-term care insurance (subject to age limits), is deductible on page 1 as an AGI adjustment and for 2010 only, can also reduce your self-employed social security tax. New Jersey will also allow medical expenses after a 2% of income reduction.
- All state and local income taxes or sales tax, whichever is higher, plus real estate, unemployment and personal property (intangible) taxes.
- Mortgage interest on mortgages up to $1,000,000 for personal and one vacation residence, (yachts, mobile homes and travel trailers may qualify), subject to some limitations. Interest expense on home equity loans up to $100,000 regardless of how the loan proceeds were used, plus points and investment interest, subject to some restrictions. For 2007 through 2010, mortgage insurance premiums on new principal residence mortgages(FHA, VA, etc.) are deductible.
- Charitable contributions, including non-cash gifts. Proof is now required for all cash contributions of any amount. **Estimated amounts are not allowed.** A substantiation letter is required for each individual gift that exceeds $250. Non-cash contributions over $250 require receipts; over $500 require receipts plus additional information; and over $5,000 require an appraisal. Donations of artwork, stock or other appreciated property can be deducted at the current fair market value with some limitations. **Note:** Deductions for donations of vehicles, boats, motor homes, etc. have been substantially restricted. Check with us before making this type of donation.
- Unreimbursed business and work-related expenses, professional/union dues, costs incurred searching for employment, investment advisory fees, tax preparation fees, etc., are deductible subject to the 2% of AGI limitation.

YOUR TAX ADVISORS.

For 2010, all of your itemized deductions will be allowed, the phase-out reduction rules have been eliminated. Also eliminated was the standard deduction add-on for real estate taxes paid.

■ ■ ■

Phase-Out of Exemption Deduction Was Eliminated

The annual deduction for personal exemptions is now the same for all taxpayers, $3,650 for 2010 and $3,700 for 2011. This and the itemized deduction phase-outs have currently been eliminated.

■ ■ ■

Child Credits

Single parents with AGI under $75,000 and married/joint families with AGI under $110,000 may receive a credit of up to $1,000 for each dependent child under age seventeen. Currently, this credit is applicable through 2012. The credit will be reduced $50 for each $1,000 of additional income. If you qualify for this credit, it is in addition to the child care and/or earned income credits and under certain conditions may be refundable.

■ ■ ■

Children

Dependent children under 19, or dependent students under 24, cannot claim themselves as exemptions on their tax returns. Dependent children may not be required to file a tax return if their investment income is below $950 and/or their earned wages are below $5,700. However, a tax return is required to receive a refund of withheld income tax. Children under 18 with investment income over $1,900 are taxed at their parents' tax rate (Kiddie Tax) and must file Form 8814.

Tax exempt or tax-deferred bonds may be a solution for these young taxpayers.

■ ■ ■

Saving for Education

Section 529 Plans continue to improve. They offer tax free earnings, allow single contributions of $13,000 annually, plus a special one time $65,000 five years at once. If a joint gift, double the contribution limits. They do not have phase-out limitations and offer lots of flexibility. More information is available at **www.collegesavings.com** and **www.collegesavings.org.**

■ ■ ■

Tax Exempt Interest Income

To maximize your after-tax income, you must first know your tax bracket. The higher your tax bracket, the greater the benefit from tax-exempt investments. See our **Equivalent Percent of Interest Income Table** at **www.omalleycpa.com** on the "**Planning for Tomorrow**" page. Income yield will be affected if bonds are purchased above or below face value. Generally, bonds must be invested in your resident state to be tax-free on your state return.

Investments

Currently through 2012, qualifying dividends (generally domestic corporations held for more than 60 days) will be taxed at 0% if your regular tax rate does not exceed 15%, or at 15% maximum if your regular tax rate exceeds 15%.

Long term capital gains for qualified sales through 2012 will be taxed at 0% if your regular tax rate does not exceed 15%, or at 15% maximum, if your regular tax rate exceeds 15%. This is the current tax law but it could change for 2013 and future years.

All investments should be reviewed periodically for risk, balance and diversification. Bank account balances, including internet banks, are FDIC insured for up to $250,000 per each individually titled account to a $3,000,000 maximum for married couples with IRA's and multiple trusts, any excess is not insured. Treasury bills and US Bonds are an excellent alternative to traditional bank instruments. Although not insured, they are backed by the US Government and tax-free on the state return.

Watch your investments closely and beware of schemes and con-artists. As many investors have found, if the return sounds too high, there may be a problem; don't get caught in a Ponzi scheme. You will sleep better if your money is invested in nice, big, public mutual funds or bona-fide listed companies through reputable brokers with SIPC insurance. Their fraud coverage is $500,000 per person, per account.

Don't use the mutual fund's name as an investment guide.

Find out how the fund is invested.

Does their mix meet your risk tolerance and diversification requirements?

The **Risk Pyramid**, on our "**Planning for Tomorrow**" page at **www.omalleycpa.com** may help you determine your investing comfort level. Mariette and Chuck are both CERTIFIED FINANCIAL PLANNER ™ Professionals, but they are not investment advisors (stock pickers) and do not sell any products. Our services are limited to analyzing and planning. We do however, have reliable contacts with a local **Edward Jones** representative and **Adviser Investments**, Dan Wiener and Jim Lowell's premier firm for investing in Vanguard and Fidelity funds. Their recommendations are based on who is the fund manager and how is the fund invested.

■ ■ ■

Social Security and Medicare

A list of Social Security data appears on the **Tax Reference Guide** - see page 5 . If you need more information, contact Social Security at 1-800-772-1213 or on the Internet at **www.socialsecurity.gov.**

. Tax Tips From

Divorce

A complex area made more difficult by complicated tax laws. A divorce property settlement agreement may be one of the most important documents you will ever sign. Before you sign it, have your tax consultant review the agreement and explain its tax consequences.

■ ■ ■

Retirement Options

Our **quick guide to retirement planning** is at **www.omalleycpa.com** on the "**Planning for Tomorrow**" page.

The various contribution limits are on the **Tax Reference Guide –** see page 5. The AGI upper phase-out limits for deductible IRA's, by an active participant in an employer-sponsored plan, have been increased to $66,000 single and $109,000 married/joint for 2010, when both spouses are active participants.

A working spouse, who is not an active participant in an employer sponsored plan, may make a tax deductible contribution if their joint AGI is less than $177,000 in 2010, even though the other spouse is an active participant.

Roth IRA contribution (not deductible) phase-out limits for 2010 are: single $120,000, and married/joint $177,000.

Check all of your IRA and employer sponsored retirement plans for a designated beneficiary, including secondary beneficiary. Generally, it should be a person and not your estate or a trust.

■ ■ ■

House Sale and Mortgage Debt Forgiveness

The sale of your principal personal residence at a gain of up to $250,000 single or $500,000 married/joint, if you have lived there for two years out of the last five years (there are some limited exceptions), will usually not be taxed. This rule applies only to your principal personal residence and does not include vacation, rental, or business properties.

An exception to the tax rules on debt forgiveness allows foreclosures and mortgage renegotiations (workouts), only on a principal personal residence, between January 1, 2007 and December 31, 2012 of up to $2 million to escape taxation.

Real Estate Loss Deductions

Real estate investments are normally capital assets, subject to the capital gain and loss rules. However, real estate rental losses are subject to the passive loss rules and are not always deductible. Suspended losses are carried forward until there is a profit or the property is sold. Taxpayers who are actively working in real estate (at least 750 hours per year) may be eligible to deduct their rental losses.

■ ■ ■

Domestic Workers Tax

The so-called "Nanny Tax" covers all domestic workers (over age 18), including baby-sitters and requires annual reporting of payroll taxes. The wage threshold is $1,700 for 2010, per employee. Employers of domestic household workers must provide a W-2 by January 31 and file a Schedule "H" (Household Employment Taxes) as part of their personal tax returns. Domestic employers may also be subject to federal and state unemployment taxes, which may require quarterly state filings and workers' compensation insurance. Check your homeowner's insurance to see if you have coverage for domestic workers.

■ ■ ■

Home Offices

If you use part of your home for business, you may be able to claim a deduction for office in home expenses, such as utilities, insurance, maintenance, depreciation, etc. To qualify for this deduction, you must use the area of your home regularly and exclusively as your principal place of business, or a place of business where you meet and deal with clients, patients, or customers in the normal course of business, or if you use a space in your home exclusively and regularly for administrative and management activities of your trade or business and you do not have another permanent location where you can conduct these activities. Employees must also prove that they used their home office for the convenience of their employer.

Because the definition of "principal place of business" has been expanded, more individuals are able to qualify for the home office deductions.

■ ■ ■

Business Expenses

The key to this area is accountability. The five W's (who, what, where, when and why) is the best method to satisfy any IRS challenge. Reimbursement plans must meet the IRS deductibility requirements. An employee/taxpayer must be required to report and justify any reimbursed expense, including the business purpose and mileage information. If expense reimbursement is based strictly on these figures, there isn't any tax impact.

However, a non-accountable plan (documentation isn't provided) – such as a car or travel allowance - will result in taxable income to the employee/taxpayer, plus it will subject the employer to payroll taxes and is includible as taxable W-2 income.

Per Diem allowances (see the **Tax Reference Guide** at **www.omalleycpa.com**, tax info page) can be paid to employees if they own less than 10% of the company, in lieu of exact expense reporting. Travel and other cost of living expenses for a temporary job assignment, which is for less than one year, are deductible.

Employees who deduct unreimbursed business expenses as part of their itemized deductions (Schedule A, Miscellaneous Deductions) are subject to the 2% AGI limitation.

Social and golf club dues, political contributions (PAC) and lobbyist travel are **not deductible**. Meals and entertainment, including sporting events, are only **50% deductible.** Working through lunch and overtime meals for employees, trade association dues and similar items are **100% deductible.**

■ ■ ■

FORM 1099'S – RENTAL PROPERTIES

The Small Business Act that was signed into law in the Fall of 2010 expanded the 1099 filing requirements for rental properties. Under the new law, if you have rental income even from a summer home, a second home or a duplex, you must provide a Form 1099 for payments of $600 or more to any service provider, such as a plumber, electrician, painter, accountant, attorney, etc. This new law became effective January 1, 2011 and Form 1099's will be due 1/31/2012.

The Small Business Act also increased the penalties for failing to properly file a required Form 1099.

■ ■ ■

FUTURE FILING REQUIREMENTS AFFECTING BUSINESSES

■ **Payroll and Corporate Taxes**

All tax deposits must now be made using the Internal Revenue Service EFTPS system. Effective January 1, 2011, existing tax deposit coupon books **can not be used.** Banks are no longer permitted to accept tax deposit coupons and checks. Tax deposits done through a bank can only be done as a wire transfer – for a fee.

■ **2011 W-2's – due 1/31/2012**

Effective January 1, 2011, employers are required to accumulate the amount paid for employees' health insurance, for reporting purposes only (not taxable), on 2011 year-end W-2's.

■ **Form 1099's – due 1/31/2013**

It appears that some of the more burdensome provisions regarding Form 1099 filing that were scheduled to go into effect January 1, 2012 may be repealed. However, the current law, which requires 1099's to be given to any unincorporated firm providing services in excess of $600 per year, will remain in effect.

Penalties for failing to properly file a Form 1099 have increased.

Annual Tax Reference Guide – The More Popular Items
See www.omalleycpa.com for a complete list

	2010	2011
Personal Exemptions	3,650	3,700
Standard Deductions		
Single	5,700	5.800
Married/Joint	11,400	11,600
Standard Mileage Rates		
Business use	$0.50	$.051
Non business use		
Charitable	$0.14	$.014
Medical	$0.165	$0.19
Moving	$0.165	$0.19
Education Credits/Deductions		
American Opportunity Tax Credit	2,500	2,500
Student Loan Interest Deduction		
Single		
Income below $60,000	2,500	2,500
Income above $75,000	None	None
Married/Joint		
Income below $120,000	2,500	2,500
Income above $150,000	None	None
Maximum Contributions to Retirement Plans		
IRA's - Traditional and Roth	5,000	5,000
IRA's - Non-working spouse	5,000	5,000
Age 50 + additional contribution	1,000	1,000
401K, 403B, 457, and SARSEP	16,500	16,500
Age 50 + additional contribution	5,500	5,500
Simple IRA plans	11,500	11,500
Age 50 + additional contribution	2,500	2,500
Social Security		
Taxable Wage Limits	106,800	106,800
Employee		
Tax Rate	6.2%	4.2%
Maximum Tax	6,622	4,486
Self-employed		
Tax Rate	12.4%	10.4%
Maximum Tax	13,243	11,107
Medicare Tax		
Taxable Wage Limits	No Limits	No Limits
Tax Rate		
Employee	1.45%	1.45%
Self-employed	2.9%	2.9%
Earnings Limits if Collecting		
Prior to full retirement age	14,160	14,160
Full retirement age	37,680	37,680
Beyond full retirement age	No Limit	No Limit
Health Savings Accounts		
Contribution, plan deduction not to exceed:		
Single	3.050	3,050
Married/Joint	6,150	6,150
Age 55+ additional contribution	1,000	1,000
Federal estate and gift tax exemptions		
Federal estate tax exemption	*	5,000,000
Annual per person	13,000	13,000
Lifetime exclusion (for estate planning)	1,000,000	5,000,000

*Explanantion of options are on Page 8.

. Tax Tips From

THE "BUSH TAX CUT" EXTENSION

Essentially all tax returns for the years ending December 31, 2010, 2011 and 2012 will follow the same set of rules, similar to 2009, with limited exceptions, as noted below.

TAX RATES

Individual Tax Rates For 2010

(AGI less itemized or standard deductions and allowed exemptions)

Tax Rate	Single Income			Married/Joint Income		
10%	Up	to	$8,375	Up	to	$16,750
15%	$8,375	to	$34,000	$16,750	to	$68,000
25%	$34,000	to	$82,400	$68,000	to	$137,300
28%	$82,400	to	$171,850	$137,300	to	$209,250
33%	$171,850	to	$373,650	$209,250	to	$373,650
35%	Over $373,650			Over $373,650		

Projected Individual Tax Rates For 2011

(AGI less itemized or standard deductions and allowed exemptions)

Tax Rate	Single Income			Married/Joint Income		
10%	Up	to	$8,500	Up	to	$17,000
15%	$8,500	to	$34,500	$17,000	to	$69,000
25%	$34,500	to	$83,600	$69,000	to	$139,350
28%	$83,600	to	$174,400	$139,350	to	$212,300
33%	$174,400	to	$379,150	$212,300	to	$379,150
35%	Over $379,150			Over $379,150		

2012 Tax Rates will be approximately the same but indexed for inflation.
(AGI is Adjusted Gross Income)

Many of the 2001 and 2003 "Bush Tax Cuts" were extended and are detailed in the regular section of this newsletter.

- Lower tax rates on dividends and capital gains are under investments.
- Child credits; Saving for education; Retirement options; Teacher's expense deductions, etc. are under their own headings.

■ ■ ■

Student Loan Interest

This write off, which can be as much as $2,500 without itemizing (subject to the income phase out rules), was extended through 2012 using the prior years more favorable rules.

■ ■ ■

Employer Educational Assistance Plans

The $5,250 annual Federal income tax free payments to eligible employees for the cost of college and/or graduate school was extended and does not need to be job related.

■ ■ ■

Earned Income Tax Credit

Extends prior favorable rules for low income families with three or more qualifying children.

OTHER TAX CUT CHANGES AND EXTENSIONS

REDUCTION IN SOCIAL SECURITY TAX FOR 2011 ONLY

Employees will have 2% (4.2% not 6.2%) less taxes withheld from their pay during 2011 for Social Security taxes. The maximum tax savings is $2,136 (maximum wage limit of $106,800 x 2%) per taxpayer.

Self-employed individuals will pay 2% (10.4% not 12.4%) for the same tax savings benefits as employees. For 2010 only, self-employed can reduce taxable social security by the amount of health care and long term care insurance costs, subject to limitations.

Employers will still pay the original matching rate of 6.2% for Social Security.

NOTE: The Medicare tax rates of 1.45% withheld, and 2.9% for the self-employed have not been reduced. This 2% payroll tax "holiday" replaces last year's "Making Work Pay Credit" which provided a tax credit to many taxpayers of up to $400 single/$800 married/joint. Anyone with earned income of more than $20,000 will experience a larger tax savings on a per pay basis.

IRA CHARITABLE DONATIONS EXTENDED THROUGH 2011

Available only to IRA owners over the age of 70½, a direct IRA donation of up to $100,000 per year can be used to reduce/offset the annual required minimum distribution.

■ ■ ■

AMERICAN OPPORTUNITY CREDIT

This credit of up to $2,500, which frequently is more beneficial than the college tuition deduction, has been extended along with the college tuition deduction. You choose the best, but the tuition deduction ends in 2011.

■ ■ ■

BUSINESS INCENTIVES

A variety of bonus depreciations that include a 100% write off on purchases between September 8, 2010 through December 31, 2011, and a 50% write off for purchases during any other time period of 2010 through the end of 2012 with high equipment investment dollar limitations.

WASHINGTON WATCH

continued from page 1

The GOP leaders clearly remember the voters' reaction to former Speaker Newt Gingrich's and President Bill Clinton's public relations war.

However, with 106 new members in Congress (86 Republicans and 8 Democrats in the House, plus 9 Republicans and 3 Democrats in the Senate), many of them fiscally conservative Tea Party members, agreeing on what spending to cut will be challenging.

In 1995, the U.S. debt was almost $5 trillion; it had grown $800 million during President Clinton's first two years. The U.S. debt was $5.7 trillion when George W. Bush took office and it grew to $10.6 trillion during his eight years. The current two year $3.4 trillion increase vs. the prior eight year $4.9 trillion increase, compared to Clinton's $1.5 trillion eight year increase is certainly a good reason for sounding the deficit alarm.

The last time the USA was not in debt was 1835. Balanced budgets and no debts are rare in America's history. In recent years, only 1956/1957; 1969; 1998 through 2001 have had balanced budgets with revenue surpluses.

HOW DID THIS HAPPEN? WHAT HAS CAUSED IT?

The government does not issue normal business-like accounting reports:

> "…The Government Accountability Office was unable to provide an audit opinion on the 2010 financial statements due to 'widespread material internal control weaknesses, significant uncertainties, and other limitations', although it noted that significant progress had been made. The GAO cited as the principal obstacle to its provision of an audit opinion 'serious financial management problems at the Department of Defense that made its financial statements unauditable'. The GAO identified during its audit work an estimated $125.4 billion of 'improper payments'. Thirteen of the twenty-four Government Agency Heads either qualified or withheld their assurance statements…"

The government operates on a cash-in, cash-out basis and does not include uncollected tax revenue as income. Expenditures do not include unfunded future liabilities for Social Security, Medicare, etc., as expenses or outflows. The most recent usable financial information available

continued on page 10

. Tax Tips From

FEDERAL ESTATE TAX
(Your state rules may not have changed)

The new Federal estate tax rules are particularly confusing. Congress actually made the estate tax rules retroactive to 2010, with a $5 million exemption, a 35% rate and the date-of-death value serving as the tax basis for inherited assets. However, estates of decedents dying after December 31, 2009 and before January 1, 2011, at their option may elect to not come under the revised estate tax. The new law gives these estates the option to elect:

- No estate tax and modified carryover basis rules under the prior "Bush Tax Cut" laws, for inherited assets that have appreciated by more than $1.3 million, plus $3 million for assets passing to a surviving spouse, -OR -
- The estate tax based on the new 35% top rate and $5 million applicable exclusion amount with stepped-up basis. Any election would be revocable only with the consent of the IRS.

The 2010 Tax Relief Act gives Federal estates of decedents dying after December 31, 2009, and before December 17, 2010 (date of enactment), extended time (generally nine months) to perform certain acts. These include the filing of any return and the making of any payment.

For 2011, the exemption is $5 million with a 35% rate, and inherited assets get a stepped-up basis. For 2012 the exemption will be indexed. The Tax Relief Act provides for portability between spouses of the estate tax applicable exclusion amount. Generally, portability would allow a surviving spouse to elect to take advantage of the unused portion of the estate tax applicable exclusion amount of his or her predeceased spouse with a larger exclusion amount. A "deceased spousal unused exclusion amount" would be available to the surviving spouse only if an election is made on a timely filed estate tax return. Portability would be available to the estates of decedents dying after December 31, 2010. Under the Tax Relief Act, the portability election will sunset on January 1, 2013.

■ ■ ■

Gift Taxes

For gifts made in 2010, the tax is computed using a rate schedule having a top tax rate of 35% and an applicable exclusion amount of $1 million. For gifts made after 2010, the gift tax is reunified with the estate tax with a top gift tax rate of 35% and an applicable exclusion amount of $5 million.

■ ■ ■

Generation Skipping Tax (GST Tax)

The Act provides a $5 million exemption amount for 2010 (equal to the applicable exclusion amount for estate tax purposes) with a GST tax rate of zero percent for 2010. For transfers made after 2010, the GST tax rate would be equal to the highest estate and gift tax rate in effect for the year (35% for 2011 and 2012). The 2010 Tax Relief Act also extends certain technical provisions under the prior "Bush Tax Cut" laws affecting the GST tax. In 2013, the exemption is scheduled to fall again to $1 million with a 55% top rate.

If all of this sounds confusing to you, you are not alone. To make proper decisions and elections, you need an experienced estate attorney and a qualified CPA who understands the old and new estate tax laws.

■ ■ ■

IN TWO YEARS, EXPECT TAXATION AND THE DEBT CRISIS, TO BECOME A PRESIDENTIAL ELECTION YEAR ISSUE.

■ ■ ■

SIMPLIFY YOUR BUSINESS RETIREMENT PLAN

By, Mariette T. O'Malley, CPA, J.D. (Tax), CFP®

No question the economic situation has made it very difficult for small businesses to survive, let alone offer competitive salary and benefit packages to their employees. As small business owners, the increasing costs of employee fringe benefits have put them in a stranglehold. The uncontrollable rise in workers' compensation insurance, health insurance, life insurance, all benefits that provide for the employee, don't leave much "financial" room for the traditional pension or profit sharing plans of yesteryear.

The "BIG GUYS" have solved this problem by convincing the American workers that a 401(k) plan is the optimal retirement plan, but the costs for a small employer to manage a 401(k) plan can be frightening. In an effort to address this issue, the "Safe Harbor" 401(k) was created and to a certain extent that can work but it still requires annual filings and comes with a great deal of paperwork and responsibility for the employer.

So what's the "LITTLE GUY" to do? Perhaps its time to go SIMPLE! Back in 1997, Congress introduced a very different style of retirement plan that combined some of the best elements of a 401(k) plan and an IRA. Simplicity itself, Congress in a momentary show of brilliance, actually named the plan "Savings Incentive Match Plan for Employees" aka SIMPLE.

There are actually two types of SIMPLE, a 401(k) style and an IRA style. The differences between them are relatively minor although the IRA style is a bit easier and more commonly used, so I will focus on that. The concept with this plan is that the employee contributes to their own retirement, similar to a 401(k), although the limit is lower, employees can only contribute $11,500 ($14,000 if age 50+) in a SIMPLE Plan. There is a required employer matching contribution, very similar to the "Safe Harbor" 401(k). The contribution minimum limit is relatively low; basically either 2% or 3% of salary depending on the employer's "matching" choice. The employer, at their option, can choose to make contributions for only those employees who participate in the SIMPLE (3%), effectively rewarding the employees who save for retirement, or the employer can choose to provide a slightly smaller contribution (2%) for every "eligible" employee.

The term "eligible" employee is actually very important in a SIMPLE Plan. Traditional retirement plans, including 401(k) plans, allow employers to prescribe certain limitations on who may participate and how. Because of this, small employers frequently ran into problems with the top heavy rules, requiring them to make larger contributions for non-key employees and reduce their own 401(k) deduction. As a result, traditional retirement plans are subject to expensive non-discrimination testing, annual filings with the Department of Labor and extra administrative costs. SIMPLE Plans avoid these added costs by adhering to government imposed requirements that basically provide the same benefit for everyone. The result, employees who made at least $5,000 in the prior year, are eligible to participate in the SIMPLE in the current year. This means that even your part time employees may be eligible to participate. In the current marketplace, this may actually be a hiring advantage for a small employer who can now offer a retirement fringe benefit to the employee who works seasonally or part-time.

The functionality of the SIMPLE is simple too. Basically the deferred funds are withheld from the employees pay and deposited directly to an IRA style account in the employee's name. The employer does not have to be involved with investment choices, ongoing paperwork, or many of the other managerial responsibilities. More importantly, the administrative cost related to those responsibilities is also gone, making the plan more cost effective. While all of this may sound good, the true benefit of the SIMPLE is the control gained by management over costs. Management can now predict, based on salary, what they are obligated to pay, no more budget busting headaches at the end of the year.

It's not perfect, but it does offer an alternative to the more costly plans. A SIMPLE Plan does require some management. Who's participating; who wants to stop participating; sending the paperwork to employees' investment companies but it is relatively "light" when compared to traditional plans. Initially, there are some filing documents and notification requirements to the employees, the trickiest part about this is that employees must be notified at least 60 days before the SIMPLE goes into effect, but annual filings are not required.

Most of the major payroll service companies can handle all of the details for SIMPLE Plans just as easily as they do Section 125 Cafeteria Plans and other payroll deductions and payments. Of course, SIMPLE Plans aren't for every employer, to be eligible an employer must have less than 100 employees and SIMPLE Plans can't be combined with other plans – it's a loner.

So, maybe this year, as the employees push for both a raise and a retirement benefit, you counter with what the "BIG GUYS" did - make them save for their own retirement with a payroll deduction!

WASHINGTON WATCH

continued from page 7

is from the fiscal year ended September 30, 2009.

Total collected receipts $2.1 trillion	Billion	Ratio
Individual taxes Includes unincorporated business	$915.3	43.5%
Social Security & Medicare taxes	$890.9	42.3%
Corporation taxes	$138.2	6.6%
Excise taxes	$62.5	3.0%
Other receipts	$98.1	4.6%

AGI Percentile	AGI Minimum	Percent of Paid Tax
Top 1%	$380,400	38.0%
Next 4%	$159,600	20.7%
Next 5%	$113,800	11.2%
Next 15%	$67,300	16.4%
Next 25%	$33,000	11.0%
Bottom 50%	Below $33,000	2.7%

Total outflows - $3.5 trillion	Billion	Ratio
Social Security	$683.0	19.4%
Medicare	$430.1	12.2%
National Defense	$661.1	18.8%
Unemployment	$533.2	15.2%
Health	$334.3	9.5%
Commerce and Housing	$291.5	8.3%
Interest	$186.9	5.3%
Veterans Benefits and Service	$95.4	2.7%
Transportation	$84.3	2.4%
Education, Training, Employment, Social Services	$79.7	2.3%
Administration of Justice	$51.6	1.5%
Other Expenditures*	$86.6	2.4%

*Other Expenditures include International Affairs, Science, Space, Technology, Energy, Environment, Natural Resources, Agricultural, Regional Development and General Government, totaling 4.1% of collected receipts.

As the $3.5 trillion total outflow schedule from 2009 indicates, Social Security, Medicare, National Defense, Unemployment, Health, Commerce, Housing and Interest make up 88.7% of the budget. Lots of big amount expenditures, but also well protected areas.

These are the ugly facts, the government spent 67% more than it received in 2009.

$4.6 trillion of the $14 trillion debt is owed to various government trust funds, including $2.6 trillion owed to the Social Security Trust Fund. The remaining $9.4 trillion is owed to the public, including about $4.4 trillion to foreign countries. China and Japan are each owed about $900 billion; England (UK) is owed about $510 billion, and Oil Exporters representing 15 countries are owed approximately $211 billion, with the remaining $1.9 trillion spread around the rest of the world.

While the USA owes the most in total dollars, it does not owe the most either by Gross Domestic Product (GDP) or per capita (based on population), England (UK), Germany and most of Europe, plus many other countries owe more. The following compilation of facts may help you evaluate the overall USA debt position.

	GDP Trillion	DEBT Trillion	SQ.MILES Million	POPULATION Million	BILLIONAIRES How Many
WORLD	$62.0	57.0	193.100	6,896.0	1011
USA	$14.6	14.6	3.794	308.7	422
CHINA	$7.8	0.3	3.705	1,330.0	66
JAPAN	$4.5	2.1	0.146	127.3	22
INDIA	$3.3	0.2	1.269	1,148.0	52
GERMANY	$2.9	5.2	0.138	82.4	57
ENGLAND (UK)	$2.3	9.1	0.095	61.0	30
RUSSIA	$2.2	0.4	6.593	140.7	65
CANADA	$1.4	0.8	3.855	33.1	24

Obviously, the total debt from prior annual deficits and the current year's budget, which ends on September 30, 2011, have created concerns, but while there are many cutting efforts from diversely interested groups, the reality is, the current fiscal year is almost half over. Next year's budget (fiscal 2012) is already in the development stage with President Obama enumerating his ideas in his State of the Union address, to "**sustain the American Dream**" by investing in,

"…innovation, education, and infrastructure – will make America a better place to do business and create jobs…"

(continued on page 11)

WASHINGTON WATCH

continued from page 10

He developed these themes by reminding us how in the past, the job market grew by "**creativity and imagination**," everything from Edison, Ford and the Wright Brothers, to Google and the internet. He expounded upon NASA's commitment to the space program and encouraged increasing science, research and technology, calling this time period "**…our Sputnik moment…**" Energy, infrastructure, high speed railroads, but he also recognized that these advancements will cost budget money that is currently not available. The President proposed a:

> "…21st century government that's open and competent. A government that lives within its means. An economy that's driven by new skills and new ideas. Our success in this new and changing world will require reform, responsibility, and innovation…but to help our companies compete, we also have to knock down barriers that stand in the way of their success…For example, over the years, a parade of lobbyists has rigged the tax code to benefit particular companies and industries…So tonight, I'm asking Democrats and Republicans to simplify the system. Get rid of the loopholes. Level the playing field. And use the savings to lower the corporate tax rate for the first time in 25 years – without adding to our deficit…"

And he agreed that:

> "…we freeze annual domestic spending for the next five years…this would reduce the deficit by more than $400 billion over the next decade, and will bring discretionary spending to the lowest share of our economy since Dwight Eisenhower was President…This freeze will require painful cuts. I've proposed cuts to things I care deeply about, like community action programs. The Secretary of Defense has also agreed to cut tens of billions of dollars in spending…I recognize that some in this chamber have already proposed deeper cuts, and I'm willing to eliminate whatever we can honestly afford to do without. But let's make sure that we're not doing it on the backs of our most vulnerable citizens….most of the cuts and savings I've proposed only address annual domestic spending, which represents a little more than 12 percent of our budget. To make further progress, we have to stop pretending that cutting this kind of spending alone will be enough. It won't…The bipartisan fiscal commission I created last year made this crystal clear…Their conclusion is that the only way to tackle our deficit is to cut excessive spending wherever we find it – in domestic spending, defense spending, health care spending, and spending through tax breaks and loopholes…This means further reducing health care costs, including programs like Medicare and Medicaid, which are the single biggest contributor to our long-term deficit. The health insurance law we passed last year will slow these rising costs… I'm willing to look at other ideas to bring down costs, including medical malpractice reform…"

In my opinion, the "Health Care Reform Act" with its yearly phase in dates, is still a work in process. The enclosed "Health Care Reform Means Change", is compliments of our Paychex representative, Ryan J. Garber, along with his AICPA Partner Program Certificate. The President went on to say:

> "…To put us on solid ground, we should also find a bipartisan solution to strengthen Social Security … without subjecting Americans' to the whims of the stock market… And if we truly care about our deficit, we simply can't afford a permanent extension of the tax cuts for the wealthiest 2 percent of Americans…It's not a matter of punishing their success. It's about promoting America's success…In fact, the best thing we could do is to simplify the individual tax code… This will be a tough job, but members of both parties have expressed an interest in doing this…"

At this point in President Obama's speech, I thought about the closing remarks from John F. Kennedy's inaugural address:

> "…And so, my fellow Americans: ask not what your country can do for you – ask what you can do for your country…"

And while I thought of JFK's famous words, I remembered President Reagan's words on compromise:

> "…When I began entering into the give and take of legislative bargaining in Sacramento, a lot of the most radical conservatives who had supported me during the election didn't like it. 'Compromise' was a dirty word to them and they wouldn't face the fact that we couldn't get all of what we wanted today. They wanted all or nothing…I'd learned while negotiating union contracts that you seldom got everything you asked for…I agreed with FDR:'I have no expectations of making a hit every time I come to bat.' If you got seventy-five or eighty percent of what you were asking for, I say, you take it and fight for the rest later…"

(continued on back page)

Washington Watch

continued from page 11

President Obama has recently rearranged his cabinet and now two former President Clinton cabinet officers are also in Obama's cabinet. William Daley, Clinton's Secretary of Commerce is now Obama's Chief of Staff, and Jacob Lew, Clinton's Director of the Office of Management and Budget is back in his old job, right behind William Daley and Vice President Joe Biden in advising the President. His February 5th New York Times editorial "The Easy Cuts are Behind Us" is on Google. Also on Google is Maya MacGuineas'(former Concord Coalition member and President of the Committee For a Responsible Federal Budget) CNN Opinion piece, "National Debt: No More Excuses".

The big question is, to solve the revenue and expense shortfall, are all of the taxpayers ready to answer JFK's call "…ask what you can do for your country…" My Revenue Schedules clearly show that Individual, Social Security and Medicare taxes accounted for 85.8% of the total 2009 revenue. In 1963 the top individual tax rate was 91%; by 1982 it had been lowered to 50%, and then to 28% in 1988, but in 1993 it went back up to 39.6%, and then in 2003 back down to it's current 35%. According to David Cry Johnston, Tax Analyst, author and former New York Times tax reporter, in 2007 an IRS website report indicated that the top 400 earners paid (including Social Security and Medicare) a total tax rate of only 16.6% on their income because their income was mainly from capital gains and dividends, not wages.

The 2010 USA census reported an overall 9.7% population growth (much higher than most developed countries), with a 14.3% increase in the South; 13.8% on the West coast but only 3.2% in the Northeast and Midwest. California is still the most populated state, followed by Texas, New York, Florida and Illinois. The census results will shift eleven Congressional seats from the Northeast and Midwest to the South and West with Texas being the biggest winner, gaining four seats and New York and Ohio each losing two seats. New Jersey and Pennsylvania may lose one seat each. The shift in population, plus individual state re-districting will influence the 2012 elections.

Now that the GOP is in control of the House (242 to 193) and has 47 seats in the Senate, both parties have shared responsibility. Watch future editions of **News & Views** as Congress and President Obama try to improve fiscal deficiencies by cutting the budget, rearranging priorities and possibly some tax code revenue enhancements. With or without bipartisan cooperation, this session of Congress should be interesting and hopefully productive.