

ANSPACH FINANCIAL GROUP

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FALL NEWSLETTER

SEPTEMBER, 2008

Tax Issues of Providing Care for Elderly Parents

There comes a time when many of our elderly parents require assistance in order to remain in their own home. If I engage in-home care services, how do my parents pay the care providers? Are they employees or independent contractors? Can my parents deduct the cost of the homecare on their tax return?

If you pay a home healthcare agency that provides caregivers, you don't have any payroll reporting responsibilities. However, if you pay caregivers directly for services provided in the home, they are household employees and must be treated as such. They cannot be treated as independent contractors. This means you are responsible for withholding payroll taxes and filing the required payroll tax returns. There is a federal provision for reporting and paying household employee payroll taxes on an individual income tax return. California does not have a similar provision, and payroll tax returns must be filed. Income tax withholding is optional, but you are required to issue W-2s to these providers. We strongly recommend using a payroll service company to handle all of the reporting requirements as errors can incur costly tax penalties.

Payments for home healthcare services may be tax deductible as medical expenses if they are for "qualified long-term care services" and are not reimbursable by long-term care insurance. To qualify, these services must be required by a "chronically ill individual" and provided under a plan of care prescribed by a licensed health care practitioner. A "chronically ill" person must have been certified by a licensed health care practitioner within the previous 12 months as being unable to perform at least two of the "activities of daily living" (ADLs) due to loss of functional capacity for a period of not less than 90 days. These ADLs are eating, toileting, bathing, dressing, transferring, and continence. A person with severe cognitive impairment who can still perform all the ADLs will also qualify if they require substantial supervision to maintain their health and safety.

New Legislation Helps First-Time Homebuyers

The Housing Assistance Act of 2008 has provisions that will impact many taxpayers.

Tax credit for first-time homebuyers

A refundable tax credit of 10% of the purchase price up to \$7,500 is available for homes purchased as a principal residence between April 9, 2008 and June 30, 2009.

- Taxpayers are considered first-time buyers if they have not had an ownership interest in a principal residence in the U.S. during the 3-year period prior to purchase of the home to which the credit applies.

The credit phases out for individual taxpayers with modified adjusted gross income between \$75,000 and

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Special points of interest:

- The government is offering a tax incentive to assist taxpayers with the purchase of a first home for a limited period only.
- Our firm is offering new electronic delivery options to our clients, and we want to hear back from you on the enclosed postcard.

IRA Contributions and Rollover Pitfalls

Determining if you are eligible to make an IRA contribution and how much to contribute can be more confusing than you think. Are you eligible to contribute to a regular IRA, Roth-IRA, SEP-IRA, or a SIMPLE-IRA? How much can you contribute to each of these types of IRAs and how much is deductible? What is the best strategy for you?

All these questions must be addressed in order to make an informed decision of where (and where not) to put your money. Many taxpayers do seek the appropriate advice we can provide in answer to these questions. Correcting mistakes is far more time-consuming and expensive than getting the right advice before making IRA contributions.

Rollovers of retirement accounts and IRA accounts can be very complex as well. What are the options if you inherit an IRA or retirement account? Do you know the difference between a rollover to a regular IRA and one to a conduit IRA? What kind of beneficiary IRA do you need to set up to receive funds from an inherited IRA or other retirement plan?

Should you roll over company stock in your 401(k) to an IRA? Should you get a check or utilize a trustee-to-trustee transfer? What about including after-tax contributions in the rollover?

Again, these are questions that we can help you address before making decisions that are for the most part irrevocable and can have major tax implications.

New Legislation Helps First-Time Homebuyers

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\$90,000 (\$150,000 and \$170,000 for joint filers) for the year of purchase.

- The tax credit is refundable, so any amount of the credit that exceeds your tax liability will be refunded.
- Taxpayers may treat a home purchased between January 1 and June 30, 2009 as if it was purchased in 2008, accelerating the credit to the 2008 tax return.
- **This credit is required to be repaid.** Taxpayers are required to repay 1/15 of their credit each year beginning in the second year after the credit is taken. Someone with a 2008 credit of \$7,500 will pay back \$500/year beginning with the 2010 tax return. If the home is sold or no longer qualifies as a principal residence before the credit is fully repaid, the remaining repayment is due in the year of sale (or cessation of use as a principal residence). This repayment amount cannot exceed the gain on the sale to an unrelated party, and there is no repayment after the death of a taxpayer.

Property tax deduction for non-itemizers

For 2008 only, a new addition to the standard deduction (for those taxpayers unable to itemize deductions) is a property tax deduction of \$500 for individuals and \$1,000 for joint filers.

- This deduction cannot exceed the amount of property tax actually paid.
- Any property taxes taken elsewhere on the tax return (such as on Schedule C or Schedule E) do not qualify for this deduction.

Home sale exclusion rules tightened

Most taxpayers are aware of the exclusions from taxable gain for the sale of a principal residence. Taxpayers may exclude up to \$250,000 of gain from the sale of a home owned and used as a principal residence by the taxpayer for at least 2 of the 5 years prior to the sale. To qualify, the taxpayer must not have used the exclusion on a sale within 2 years of the sale date. Married taxpayers filing jointly in the year of sale may exclude up to \$500,000 of the gain if: 1) either spouse owned the home for at least 2 of the 5 years prior to the sale, 2) both spouses used the home as a principal residence for at least 2 of the 5 years before the sale, and 3) neither spouse is ineligible for the exclusion due to the once-every-2-year limit.

The new law reduces the excludable gain if there is any disqualified use during the home ownership period.

- Disqualified use is any use **not** as a principal residence beginning in 2009. There are exceptions to this definition for: 1) use after the home has been a principal residence, 2) qualified official extended duty, or 3) temporary absences due to employment, health conditions or other unforeseeable circumstances.
- The law applies to sales beginning in 2009. It is **not** retroactive.
- The reduction of the exclusion is a ratio of post-2008 disqualified use divided by the total ownership period. *You can view two examples of the application of these new rules on our Website under "Updates".*

These new rules make it even more important to track home improvements that will add to the cost basis of your home and reduce the gain on a subsequent sale. See the article on tracking home improvements.

Tracking Home Improvements

Taxable gain on the sale of a principal residence has become more common due to market appreciation and long holding periods, particularly for the elderly. This is in spite of liberalization of the gain exclusion rules enacted in 1997 (\$500,000 for joint filers and \$250,000 for singles). The cost of any home improvement you made during all the years of ownership will reduce the amount of taxable gain on the sale, but many homeowners have not kept complete records of all qualifying expenditures.

Improvements add value to your home or extend its useful life but do not include ordinary repairs and maintenance. Structural modifications including additions and remodels are considered improvements, as are integrated systems (security, HVAC, etc.) and land upgrades (driveways, fences, landscaping, etc.). Providing documentation for the cost of these improvements is often a challenge. Contracts, cancelled checks and receipts are the best, but there are other methods to prove that you made and paid for improvements. Often, before and after photographs will substantiate the work. Even a list of improvements with approximate date and cost can be considered valid documentation.

For taxpayers who have owned their residence for 20-30 years or longer, documentation of improvements and their cost is especially difficult. We often tell our clients to simply do the best they can to reconstruct this information for us to review and determine the amount to add to the cost basis of the home.

Cost Basis of Gifts & Inheritances

One of the most common problems we see in our office is the determination of the cost basis (value used for determining gain or loss on a sale) of gifted or inherited assets. If you buy securities or real estate, your cost basis is what you pay for that investment. However, when you inherit an asset, the cost basis is usually its fair market value on the decedent's date of death. When you receive an asset as a gift, its cost basis is the same as the owner's cost basis immediately prior to giving it to you.

Many taxpayers hold the gifted or inherited asset for years before selling it and have no information about its tax basis. Here's what you should do. If you receive a gift of securities or other appreciable asset, ask your benefactor to provide you with their cost basis information as well. When you inherit an asset, the executor or trustee should provide you with a date of death or other tax basis valuation. If not, ask them for this information and keep it with your other important records. We can also keep a copy of the basis information in your file to calculate the taxable gain or loss when you later have sales transactions to report. Remember, IRS takes the position that, if you cannot determine basis, your basis is zero and 100% of the sales proceeds are taxable.

Miscellany

Here's the answer to the question posed in the last newsletter of June, 2008. As you may recall, Lydia attended a charitable auction in 2007 and paid \$100 for a bottle of wine that had a fair market value of \$50. She was able to take a \$50 charitable deduction on her 2007 income tax return. The next year she donated the same bottle of wine back to the charity for their 2008 auction. The wine had retained its \$50 FMV, so Lydia will be able to deduct \$50 as a non-cash charitable contribution on her 2008 return.

We have a put a link on our Website to a new online Social Security Retirement Benefits Calculator. It's tied to your actual Social Security earnings record and allows you to explore different scenarios for retirement age and future earnings.

Save Trees with Electronic Delivery

As reported in our Summer Newsletter we now offer email delivery of our newsletter. We are offering electronic delivery of your tax organizers as well. We can email your 2008 tax organizer in a pdf file. It's not interactive, but you can print out only the relevant pages that you need to provide information and return to us with your tax documents.

You can also request secure electronic delivery of your tax returns that we prepare. Many of our clients find the electronic version much easier to store and access than the paper returns.

Please take a moment to review the electronic delivery options listed on the enclosed postcard, indicate your preferences and return to us. You can also call or email this information to Cindi Jones, our office manager.

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ANSPACH FINANCIAL GROUP *TAX AND FINANCIAL PLANNING*

**FALL NEWSLETTER
SEPTEMBER, 2008**

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At Anspach Financial Group, we are committed to providing valuable and personalized services to each of our clients. We strive to solve complex tax and related issues by combining technical expertise with creative planning and problem solving. The experience, professional credentials and personal attention of our partners provide our clients with superior services at reasonable cost.

Calendar

Tax Due Dates

- September 15 Final filing due date for calendar year corporation returns on extension
- September 15 Third quarter estimated tax payments due
- October 15 Final filing due date for individual, partnership and fiduciary returns on extension
- October 31 Due date for third quarter payroll tax returns
- December 10 Final due date for property tax installment

Anspach Financial Group Calendar

- August 31*** Deadline for providing all required information for the preparation of 2007 calendar year corporation returns to guarantee completion by September 15
- September 30 *** Deadline for providing all required information for the preparation of 2007 individual, partnership and fiduciary returns to guarantee completion by October 15

*** Please make arrangements to get your 2007 tax information to us as soon as you possibly can.**

- November 1 -
- December 15 Best time for end of the year tax planning