George Johnson & Company Informer

Summer 2010

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To Our Clients and Friends:

This past spring, in an effort to improve our client service delivery, our firm began working with The Rainmaker Academy of Nashville, TN, in order to become a five-star service provider. The goal of a five-star corporate culture is to provide the highest level of communication and service both internally, among team members, and externally to its valued clients.

This process of "stepping up our game" began with an all-day training session conducted offsite by two of The Rainmaker Academy's coaches. Weekly meetings of our team members and a follow-up session eight weeks later reinforced the training. The Rainmaker approach suggests that the way we treat each other, our internal customers, translates into how we treat our external customers. It is a philosophy our firm fully embraces.

Also, we are pleased to announce that Katie Olive and James Buckley joined our firm this summer in leadership positions. Katie, a manager, has an MBA and a Bachelor of Science degree in Accounting from Central Michigan University. She has several years of experience, both as an external auditor with a regional firm and as an internal audit manager for a global organization with international operations.

James Buckley, a Director, has 25 years of experience in public accounting, as a manager for a "Big Four" firm, and as controller for the City of Port Huron. He holds a Masters of Science and Finance and a Bachelor of Accountancy degree from Walsh College. I plan to introduce Jim to many of our clients once he becomes familiar with the services we provide them.

We hope that you find this issue of the *Informer* useful. We particularly recommend the article on the effects of health care reform on our everyday lives.

As always, if you have any questions on the topics in this letter, please do not hesitate to call us.

Sincerely,

George G. Johnson
Managing Director

SUMMER TAX TIPS

Make your summertime fun even more enjoyable by adding tax savings. With some planning, you can make it happen. Here are some ideas to consider.

- Combine business and vacation travel. Travel expenses are deductible if the travel is undertaken primarily for business purposes; thus you may wish to combine attendance at an out-of-town business conference with a visit to family or friends. The expenses attributable to the personal part of the trip, though, remain nondeductible. When doing any business traveling, make a distinction in your records between expenses for lodging and transportation and those for meals and entertainment. Only the latter are subject to a 50% deduction limitation.
- If you are going to be out of town for a while, consider renting out your home while you're gone. The IRS allows you to receive up to 14 days of rental income per year completely tax-free. In fact, you don't even have to report the income on your return.
- If you itemize your deductions, you can deduct the mortgage interest and property taxes paid for your vacation home. A boat or RV can qualify as a vacation home if it has sleeping quarters, cooking facilities, and a bathroom. If a retreat also serves as rental property, you can control your tax deductions by changing the number of days you use it for vacation.
- If you and your spouse work, the cost of sending your children to a summer day camp may qualify for the child care credit.
- If you own a business, consider hiring your child for the summer. Your child can earn up to $5,700 tax-free this year, and your business is entitled to a deduction for the wages paid. You must pay your child a reasonable wage for the work performed. If your business isn't incorporated, your child under 18 is not subject to FICA taxes.

NEW HEALTH CARE LAW INCLUDES TAX PROVISIONS

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 $25,000 or less 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 Increases 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 to every corporate recipient (other than tax-exempt entities).

Medical deductions.
Currently, you can deduct unreimbursed medical expenses in excess of 7.5% of adjusted gross income (AGI). 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.

Flexible spending accounts (FSAs).
Beginning in 2013, the maximum amount that may be contributed to a health care FSA will be limited to $2,500 (adjusted for inflation thereafter).

Here are some of the major changes by year:

2010

- A 10% tax is imposed on indoor tanning services.
- Adoption tax credit increases to $13,170, is made refundable and extended through 2011.
- Small businesses with up to 25 employees may qualify for a tax credit of up to 35% of the cost of purchasing health insurance for their employees.

2011

- A long-term care insurance program is created, financed by voluntary payroll deductions.
- Value of health insurance coverage must be reported on employees' annual Form W-2s.
- Cannot buy over-the-counter medication with funds in medical savings accounts.
- Penalty tax on nonqualified distributions from health savings accounts increases to 20%.

2012

- Form 1099s must be filed with the IRS for payments of $600 or more made to corporations.

2013

- Health flexible spending account contributions limited to $2,500 per year, indexed for inflation.
- The 7.5% income threshold for deducting unreimbursed medical expenses increases to 10% for those under age 65. For those 65 and older, the threshold remains at 7.5% through the year 2016.
- The payroll Medicare tax increases from 1.45% of wages to 2.35% on amounts above $200,000 earned by individuals and above $250,000 earned by couples filing joint returns.
- A 3.8% Medicare tax is imposed on unearned income for single taxpayers with income over $200,000 and couples with income over $250,000.

2014

- Individuals are generally required to maintain health insurance coverage or pay a penalty calculated on a percentage of their income or a flat dollar amount.
- Large employers generally must provide coverage for employees or face penalties.
- Maximum small business tax credit for providing health insurance for employees increases from 35% to 50%.

2018

- Insurance companies will be assessed a 40% excise tax on health insurance plans with annual premiums exceeding $10,200 for individual coverage and $27,500 for family coverage. Higher thresholds apply for those 55 and older and those in high-risk jobs.

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

IRS IS CONDUCTING EMPLOYMENT AUDITS

The IRS has launched a three-year auditing project that will examine about 6,000 U.S. companies for compliance with employment tax obligations. The project is the first of its kind in 25 years, and its primary objective is to collect data to identify areas of noncompliance across all industry sizes and sectors, including nonprofits and governmental entities. This data will be used by the IRS to update its audit selection formulas in an area where noncompliance is considered a serious drain on the U.S. Treasury.

Among the issues the audits will look at:

- Classification of workers as employees or independent contractors, including executives rehired as consultants, dual status employees, and employee leasing arrangements.

- Fringe benefits, including expense reimbursement arrangements and noncash benefits.
- Executive compensation and fringe benefits, executive retirement contracts, golden parachutes, and stock options.

Employers can take some steps to prepare for these payroll tax audits. For example, conduct a mock audit to check how your company handles the three focus areas – classification of workers as employees or independent contractors, fringe benefits, and executive compensation. Your company may not be selected for the research audit program, but you also need to be ready to face an audit following the three-year project.

For more information or assistance, give our office a call.

HIT YOUR TAX-CUTTING TARGET WITH SMART MID-YEAR PLANNING

With the tax law changes currently swirling around Congress, tax planning for 2010 is like trying to hit a moving target. But even in this period of uncertainty, there are definite steps you can take to score a tax-cutting bull's eye.

Review Your Retirement Plan.
Back in the mix for 2010 are required minimum distributions (RMDs) from retirement plans. After a one-year hiatus, taxpayers age 70½ and older (and those who inherited a retirement account) are again required to take taxable annual distributions. 2010 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. Note that annual distributions are not required for Roth IRAs.

On a positive note, the $100,000 income limitation for converting a traditional IRA to a Roth IRA is gone, opening the door to many taxpayers who were otherwise excluded from this popular strategy.

Contribution limits for retirement plans stay the same in 2010. For 401(k) and 403(b) plans, the maximum you can put away is $16,500. If you're 50 or older, a catch-up contribution is allowed and you can contribute up to $22,000. The contribution limit for SIMPLE plans is $11,500 ($14,000 if you're 50 or older).

Maximize Your Deductions and Credits.
Many itemized deductions and tax credits are in Congressional limbo right now. For example, some tax breaks that have expired or are about to expire might be renewed. To minimize your taxes, you need to stay aware of the status of credits and deductions so that you can adjust your planning accordingly.

One definite tax break for 2010: The phase-out of itemized deductions and personal exemptions for high-income taxpayers has been removed. The 2001 tax law gradually restored the full deduction for personal exemptions and itemized deductions for higher-income taxpayers. Effective this year, high-income taxpayers are entitled to the full $3,650 deduction for each personal exemption they take, and there will be no income-based reduction in their total itemized deductions.

As with most other provisions in the 2001 tax law, this change ends after December 31, 2010, and itemized deductions and personal exemptions will again be limited for high-incomers in 2011.

Homeowners can still score an energy tax credit. For tax years 2009 and 2010, you can receive a tax credit of 30% of the cost of qualifying home improvements made over the two-year period. The maximum credit is $1,500 for both years combined. Qualifying improvements include a new heating and air conditioning system, insulation, doors, and windows. Energy tax credits for big-ticket items, such as geothermal systems, are also available.

Developing a solid tax plan from year to year is difficult enough, but responding to this year's fluid tax law environment is especially challenging. Even so, the best tax tip remains the same: Stay in touch with us. We will be monitoring legislation for changes that could affect your tax and business situation. For a mid-year tax review, give us a call today.

NEW RULES COULD LET YOU CONVERT TO A ROTH IRA

No matter what the recent flurry of news coverage might lead you to believe, Roth IRA conversions are not new. They've been around since 1998, when Roth accounts first became available – and so have the when-how-who planning questions you're pondering now.

So what is new? 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?

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 are not 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.

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

- In 2010 and future years, you can convert traditional IRAs, SEP IRAs, SIMPLE IRAs, and certain other retirement accounts to a Roth no matter what your income is.
- If your retirement accounts contain nondeductible contributions, part of the conversion may be tax-free. Nondeductible contributions are amounts you contributed with after-tax dollars.
- The rules for making regular contributions to your Roth have not changed. For 2010, when you're married filing jointly and your adjusted gross income (AGI) is less than $167,000, you can contribute up to $5,000 (plus $1,000 catch-up if you're 50 or older). The AGI limit for a maximum contribution is $105,000 if you're single.
- If you convert to a Roth during 2010, you can choose to include one-half of the income on your 2011 federal income tax return and one-half on your 2012 return.
- Because the amount you convert is generally subject to ordinary income tax, you might need to adjust your federal and state tax estimates to avoid an underpayment penalty.
- Get the most benefit from a conversion by using non-IRA funds to pay the tax. Amounts withheld from your conversion distribution or that you withdraw from your IRA – even when you apply the money to your tax bill – can be subject to a 10% penalty.
- If you are over the AGI limit for regular Roth contributions, you can make nondeductible contributions to a traditional IRA, then convert them to a Roth.
- If you change your mind, you have until October 17, 2011, to "undo" a Roth conversion made during 2010 (called a recharacterization).
- Some states tax IRA distributions, including conversions, which may impact your decision.
- Future qualified withdrawals of your converted assets are tax-free. Even better is the fact that, with a Roth IRA, you're not required to take withdrawals at all.
- 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.
- Both current and future income tax rates 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 favors a Roth conversion. Also consider state income tax implications.
- 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.

Need more information about Roth conversions? Give us a call. We can answer your questions and help you decide the best strategy for your situation.

TAXES AND SUMMER JOBS

Does your child have 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, 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). 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.

STARTING A BUSINESS? AVOID THESE HIRING MISTAKES

Challenges that merely annoy an established firm often capsize a start-up company. This is especially true in the area of staffing. When a big corporation makes a hiring mistake, the company suffers, but survives. Committed by a fledgling firm, the same mistake may spell disaster. After all, if your company employs only five people, one wrongly hired employee will make up a fifth of your work force. That person's incompetence or poor people skills can bludgeon the firm's bottom line.

Following are three of the most common hiring mistakes made by start-up companies. Avoid these blunders and you'll be well on your way to building a productive team.

Staffing the firm with friends and family.
While this strategy may work in some circumstances, hiring pals and relatives often spells trouble. For one thing, friends and family members often expect – even subconsciously – to be treated differently from other employees. Such a double standard, whether real or perceived, can hurt morale and productivity. As a general rule, hiring decisions should focus solely on the needs of the firm and applicant qualifications.

Trusting in a handshake.
Memories fade. Expectations fluctuate. As with other important aspects of your business, employee arrangements should be laid out in writing. This can be as simple as drafting employee offer letters that cover compensation, rights to intellectual property, and bonus arrangements. Employee handbooks are also a good way to spell out the responsibilities of the firm and its staff.

Bringing in a partner for the wrong reasons.
Sure, you might save money in the short term by selling a portion of your firm to a partner. But think long and hard about the downside risks. Do you really need to surrender a portion of your company – including control over important management decisions – to someone else? What will this partner contribute? Can you find other ways to fill gaps in your team? Remember, a bad partnership may end up in the business equivalent of divorce court. So choose wisely.

For assistance with any of the issues facing your start-up business, give us a call.

ARE ALL YOUR BUSINESS EGGS IN ONE BASKET?

Many small business owners share one problem, especially in their early days. It's being over-reliant on a single customer or supplier for much of their business. If you're in that position, your business is operating with higher risk. Just as with investments, you don't want all your eggs in one basket. Your goal should be a well-diversified portfolio of customers and suppliers.

That's in an ideal world. In the real world you may have to live with the situation, at least short-term. But

there are steps you can take to understand your risk and, over time, to change it.

Measure the problem.
Work with your managers and accountant to quantify how your sales break out by customer. You only need to do this for the top five or ten customers to see whether you have an over-reliance problem. If you're a manufacturer or retailer, take a similar look at your principal suppliers. Quantify how dependent you are on the top few.

Understand the risks.
List the factors that could jeopardize your business with your chief customer or supplier. These will vary with your specific circumstances. They might include a natural disaster that interrupts your customer's business or that prevents you from shipping or receiving goods. It could be a change in the marketplace or a new technology that cuts demand for your product. It could be actions by your competitors. It might even be problems in your own operation, such as a drop in quality, delays in shipping, or poor inventory control. The list may be daunting, but until you understand the risks, you can't develop solutions.

Look for ways to minimize your risks.
Brainstorm with your managers on long-term steps to reduce each risk. It might be to enter new markets or to tweak your product design. Think through contingency plans to address possible disasters or find alternative suppliers. Discuss how you would respond to changes in the marketplace. Try to set measurable goals for change and clearly assign responsibility.

For assistance with this issue or with any of your business concerns, give us a call.

GETTING MARRIED CHANGES YOUR TAX SITUATION

If wedding bells are in your future, your tax situation will be changing also. For starters, your tax filing status will change. You will have the choice of filing a joint return with your spouse or filing a separate return as a married person.

Filing a joint return usually gives you the bigger tax savings. Both spouses' income and deductions for the entire year will be combined on to one return. Any deductions that are subject to limitations will be determined based on the combined income of both spouses.

In some cases, filing a separate return may save you taxes. A spouse who has high medical expenses or miscellaneous itemized deductions and low income, for example, might be better off filing a separate return. However, you may not claim certain credits and deductions if you file separate returns. Generally, only if you file a joint return can you claim the child and dependent care credit, the earned income credit, or education credits. Filing separate returns could affect the taxability of your Social Security benefits and the deductibility of rental losses.

The tax law has been changed to eliminate some of the additional tax that married couples once paid (called the "marriage penalty"). However, once you marry, you should review your federal income tax withholding at work. Fill out a new Form W-4 and indicate that you are married.

Several other limitations may come into play once you get married. For example, your IRA contribution may not be deductible if your spouse is covered by a retirement plan at work and your income exceeds certain limits.

Newlyweds can be faced with a surprise tax bill on April 15 unless they do advance planning. For details or planning guidance, give us a call.

WORKING AFTER RETIREMENT AFFECTS YOUR BENEFITS AND TAXES

People often work beyond the "normal" retirement age. Here's how extending your work life can affect your taxes and retirement benefits.

"Normal" retirement age is not a fixed number. For Social Security purposes, the "full" retirement age threshold ranges from 65 to 67, depending on your birth date. However, you can elect to start receiving lower payments as early as age 62, or you can maximize your benefits by forgoing them until you're 70. Once you reach age 70, there's no incentive to postpone your benefits further, since you'll already have reached your maximum.

Earnings limit.
If you're working, you probably should forgo the early payment option. Benefits received before full retirement age will be reduced by $1 for every $2 earned over an annual limit (currently $14,160). However, you will receive a compensating increase when you do reach full retirement age, and your payments will not be reduced thereafter no matter how much you earn.

Taxable benefits.
Whether or not you draw benefits, you'll continue to pay Social Security and Medicare taxes on any income you earn from wages or self-employment. Up to 85% of your benefits may become subject to income tax, depending on the amount of your other income.

Medicare.
Medicare eligibility begins the year you reach age 65. The program encompasses four types of coverage: hospital insurance, general medical insurance, Medicare Advantage, and prescription drug coverage.

Working beyond retirement age can require several complex decisions. Call us for help with planning the outcome that's best for you.

HOMEBUYER TAX CREDIT IS EXTENDED

If you signed a contract before May 1 to buy a home, but have been unable to close the deal, you still have time to apply for the homebuyer tax credit. The deadline for finalizing the paperwork on your new home has been extended through September 30, 2010.

Here's what you need to know:

- The extension applies only if you already had a contract in place by April 30, 2010. The new deadline is available for first-time homebuyers and long-time residents.
- The maximum credit remains unchanged ($8,000 for first-time homebuyers and $6,500 for long-time residents), as do other rules for qualifying.
- You can claim the credit on your 2009 or 2010 federal income tax return. You'll have to complete Form 5405, First-Time Homebuyer Credit and Repayment of the Credit, and attach proof that you meet the requirements.

Not sure if you qualify? We can help. Please call for more information.

EVERYONE NEEDS A CASH RESERVE

Many of us are living close to our financial limit these days. We pay our bills on time, but there's not a lot left over. That could be a dangerous situation. If things go wrong, your financial situation can change very quickly from adequate to critical. Without a cash reserve, you could find yourself in serious trouble.

It's important to have a cash reserve of at least three months' living expenses. Invest your reserve in a safe, liquid account. Consider investments such as a bank CD, a money market fund, or a very short-term bond fund. Make sure you have easy access to the funds without losing too much interest. And once you've built your fund, avoid temptations to raid it for non-essentials.

SUMMER'S HERE! PUT TAX SAVING ON YOUR AGENDA

Summer is the time for fun – vacations, backyard barbecues, and tax savings. Yes, tax savings. Put tax planning on your summer agenda, and you'll end up with more of your hard-earned dollars in your own pocket come 2010 tax filing time.

The tax law offers many opportunities for reducing your taxes – if you know about these options and put them in place early enough in the year to benefit from them. Are you managing your income to save credits and deductions to which you're entitled? If you're facing college expenses for someone in your family, are you doing the necessary planning to maximize available tax breaks? Have you analyzed your investments (including those in your retirement plan) to benefit from tax savings? If you're in business, tax planning at mid-year is even more vital.

Every year brings new tax rules. To put new opportunities to work for you, give us a call to schedule your summer tax-cutting review.

Your Referrals Are Appreciated

We appreciate your business, and we would appreciate your referrals. If you know someone in need of our services, please mention our name to them. We are a growing firm, and we would like more good clients like you.

Please contact our office by phone: 313.965.2655

This newsletter provides business, financial, and tax information to clients and friends of our firm. This general information should not be acted upon without first determining its application to your specific situation. For further details on any article, please contact us.