

# Burke, Montague & Associates L.L.C.

Certified Public Accountants, Advisors & Auditors

Members - Partners: Charles R. Burke, CPA Jodi K. Gill, CPA Raymond J. Raymond, CPA Kathleen C. Wilson, CPA

Professionals: Randall Hill, CPA Sheila Hessler, BS Robert Owens, CPA Richard Schiltz, CPA

Consultant: Robert J. Montague, CPA

253 West Broadway, Bradley, Illinois 60915 Phone 815.933.5641 Fax 815.939.0016

33 North Main, Manteno, Illinois 60950 Phone 815.468.8802 Fax 815.468.8805

Toll Free 800.272.8753 • www.mybmacpa.com

## Client Information Bulletin

January 2010

### Five Ways to Prepare for Tax Filings *Organize records for tax return benefits*

Now that the page has turned on another calendar year, the tax return season is fast approaching. Although you may benefit from having your family's 2009 returns prepared by an experienced professional, you still must provide the records needed to complete these filings. Logical organization of your records is a critical aspect of this process.

Here are five steps that can simplify things come tax return time. Taking this approach may also help a professional tax return preparer pinpoint various tax-saving opportunities on your personal returns.

**1. Keep records of expenses that may be claimed as itemized deductions.** Use a spreadsheet or other ledger for this purpose. The list of expenses includes real estate and income taxes, charitable donations, medical and dental expenses, interest expenses, casualty and theft losses, and miscellaneous expenses. **Note:** If you use a vehicle for business driving, it is important to maintain records of your trips in a contemporaneous diary.

**2. Separate "income" items from "expense" items.** This can simplify matters significantly when you present your files to a tax return preparer. When possible, develop subcategories for certain expenses. For example, travel and entertainment (T&E)

expenses should generally be handled separately due to their extensive substantiation requirements. **Note:** A business traveler must document the date, amount, business purpose and other details about the expense (depending on the nature of the expenditure). Also, receipts are required for T&E expenses of \$75 or more.

**3. Coordinate financial statements.** For instance, you might use a color-coding system for circling check numbers and other transactions that appear on statements. Another possibility is to use the memo lines or other spaces provided on checks or charge slips. Doing this provides a backup in the event you cannot locate income and expense files or ledgers.

**4. Observe any special tax law requirements.** For instance, the IRS recently imposed strict substantiation requirements for cash and cash-equivalent donations to charity. In general, filers are required to obtain a written confirmation from the charity or to support deductions through bank statements or receipts. Similarly, you must have access to information about securities to establish your basis for claiming capital gains and losses.

**5. Store tax return records in a safe place.** The best recordkeeping system in the world will not do you any good if you cannot locate the

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records when they are needed. Consider keeping valuable documents in a fire-resistant strongbox. Also, you might deposit check registers, credit card statements and the like in a safe deposit box until you are ready to have your return prepared.

No matter what kind of recordkeeping system you use, try to stay flexible. It may be necessary to adapt to

changes in your personal circumstances, such as buying a home or getting a divorce.

*How long should you keep your records? The IRS can generally go back up to three years to make adjustments, but this period is extended to six years for a return omitting more than 25% of your income. No limit exists if fraud is involved. Some experts recommend holding on to tax records for at least ten years.*

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- ◆ Be sensible, but take calculated risks when the situation calls for it. Identify opportunities and act on them before the window closes.
- ◆ Remember that it is more about the team than it is about you. Stressing teamwork creates an atmosphere conducive to success.
- ◆ Maximize your workday. That may mean planning to do more than you think you can accomplish in a day, getting to work a little earlier than usual and leaving late, and taking better advantage of downtime. But do not emphasize quantity over quality.
- ◆ Develop a schedule for each day and stick to it. Use all the electronic tools at your disposal to help you do your



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  - ◆ Get the most you can out of meetings. Take the feedback you receive and act on it. Don't automatically dismiss the opinions of those in lower positions.
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  - ◆ Provide instruction instead of simply ordering people around. You will find that this method produces better results and may accomplish your objectives.
  - ◆ Include other staff members in your plans. Let them know what you are doing, why you are doing it and how they can contribute to the efforts.
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- Better business management is an art, not a science. Those who exhibit common sense are more likely to be successful.*

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## The DB(k) Plan Makes Its Debut

### Introducing new hybrid retirement plan

Are you ready for a new type of retirement plan? The defined benefit 401(k) plan—or DB(k), for short—will finally be available in 2010. This hybrid plan was initially authorized by the Pension Protection Act of 2006.

**Background:** Defined benefit plans, like traditional pension plans, have declined in popularity among business owners in recent years, primarily because the plans are completely funded by the employer. Annual contributions based on actuarial computations involving years of service and salary are set aside for employees. For 2010, the contributions cannot fund an annual retirement benefit exceeding \$195,000 (see box below for retirement plan limits for 2009 and 2010).

Conversely, 401(k) plans have gained in popularity as employers seek to shift some of the funding burden to employees. For 2010, an employee can elect to defer up to \$16,500 of salary to his or her account (plus an extra \$5,500 if age 50 or older). The employer may provide matching contributions up to a specified limit (e.g., 3% of the employee's salary).

Both plans must meet nondiscrimination requirements to avoid favoring highly compensated employees (HCEs), but the testing rules for 401(k) plans are especially tough. Several "safe harbor" rules have been implemented to ease some of the burden. In addition, the plan may feature automatic enrollment to encourage a higher participation level by non-HCEs.

**New developments:** Now certain aspects of the plans are combined in the DB(k). Starting in 2010, the DB(k) is available to employers with at least two employees and no more than 500 employees.

The DB(k) typically combines a defined benefit plan based on final average pay with a safe harbor 401(k). The plan must provide a defined benefit equal to 1% of the final average pay times years of service, up to a maximum of 20% of final pay.

The 401(k) part of the plan requires automatic enrollment, with an employee deferral equal to 4% of compensation. Matching contributions for HCEs cannot exceed the matching contribution rate for non-HCEs. The basic matching contribution is 50% on up to 4% of pay. Employees are immediately vested in their 401(k) accounts.

If these requirements are met, your company has to file just one document for the plan. Also, the IRS will require only one annual report, and you do not have to endure the strenuous testing procedures for 401(k)s.

**Final words:** It is expected that the DB(k) will appeal to professional corporations and partnerships, such as medical and legal practices, as well as other small-business operations. Consult with your professional advisers.



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## Two Key Tax Changes in New Law

### Summary of new tax incentives and extensions

The new Worker, Homeownership, and Business Assistance Act was rushed through Congress and signed into law on November 6, 2009. Here is a brief summary of two key tax changes in the new legislation.

**1 First-time homebuyer credit:** The credit, which was revised by the economic stimulus law, was scheduled to expire on December 1, 2009. It was equal to the lesser of \$8,000 or 10% of the home's purchase price. A "first-time homebuyer" was defined as an individual who has not owned a principal residence for the three years prior to the purchase.

Previously, the credit began to phase out if your modified adjusted gross income (MAGI) exceeded \$150,000 for joint filers and \$75,000 for single filers. Also, you had to recapture the credit if you stopped using the home as your principal residence.

Under the new law, you may claim the credit for home purchases made before May 1, 2010 (July 1, 2010, if a binding contract is in place on May 1, 2010). In addition, the credit begins to phase out at \$225,000 of MAGI for joint filers and \$125,000 for single filers. The credit can be elected on the tax return for the year prior to the year of the purchase.

Furthermore, the credit is now available to taxpayers other than first-time homebuyers for purchases after November 6, 2009. If you have owned and used your

home as your principal residence for any five consecutive years during the previous eight years, the maximum credit is \$6,500.

**Caution:** No credit is allowed for post-November 6, 2009, purchases on a home costing more than \$800,000. Also, the prior recapture rule continues to apply.

**2 Net operating losses:** Normally, a business can carry back a net operating loss (NOL) for two years and then forward for up to 20 years. The economic stimulus law allowed a small business with gross receipts of \$15 million or less to carry back NOLs for three, four or five years in tax years beginning or ending in 2008.

Under the new law, a business can carry back losses for up to five years, regardless of its size. This option is available for NOLs incurred in either 2008 or 2009 but not both years (unless an eligible small business elected to carry back a 2008 loss under the prior rules).

The new law also limits the carryback to the fifth year to 50% of the available taxable income for the year. Any remaining NOL may be used to offset taxable income in the remaining four carryback years without any restriction. **Note:** The new NOL election must be made by the tax return due date (plus extensions) for the last tax year, beginning in 2009. This election is irrevocable.

*Consult with a professional tax adviser concerning the impact of the new law on your situation.*

## Facts and Figures

### Timely points of particular interest

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