

Client UPDATE

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The tax rules can provide relief when disaster strikes

Hurricanes, tornadoes, earthquakes, wildfires, floods, storms. Few parts of the country escape the

risk of natural disaster. If you're an unlucky victim, you may receive help from insurance and federal disaster aid. But the tax code also offers some relief. You may be able to take an itemized deduction for part of your loss. In tax terms, it's a "casualty loss," and it can also apply to events such as a car crash, a house fire, or theft. Here are the basics.

- **Sudden event.** The loss or damage must be due to an unexpected and sudden event. Losses due to slow deterioration over the years, such as rot, rust, or insect damage, don't qualify.

- **Tax deduction.** Your tax deduction won't equal your total loss. You must subtract any insurance or other reimbursement. Then you must also deduct \$100 for each loss and 10% of your adjusted gross income.

- **Basis adjustment.** Your loss may also be limited by your



adjusted basis in the property. That's generally what you paid for it, plus or minus any improvements or previous losses.

- **Disaster classification.** In a widespread disaster, the area may be classified as a "federally declared disaster area." If that happens, you have two choices. You can claim your casualty loss against the current year's taxes. Or you can amend the previous year's return and claim your loss against that year's taxes. That usually generates a faster refund, but it may change the amount of your deduction.

If you're unlucky enough to suffer a casualty loss, please contact us. We'll help you claim the maximum possible tax benefit. ♦

Act soon to save taxes

Want to lower your 2011 tax bill? The time for action is running out, so consider these tax-savers now.

- ▶ You can choose to deduct sales taxes instead of local and state income taxes. If you're planning big ticket purchases (like a car or a boat), buy before year-end to beef up your deductible amount of sales tax.

- ▶ If you're a teacher, don't overlook the deduction for up to \$250 for classroom supplies you purchase in 2011.

- ▶ Consider prepaying college tuition you'll owe for the first semester of 2012. This year you can deduct up to \$4,000 for higher education expenses. Income limits apply.

- ▶ Max out your retirement plan contributions. You can set aside \$5,000 in an IRA (\$6,000 if you're 50 or older), \$11,500 in a SIMPLE (\$14,000 if you're 50 or older), or \$16,500 in a 401(k) plan (\$22,000 if you're 50 or older).

- ▶ Establish a pension plan for your small business. You may qualify for a tax credit of up to \$500 in each of the plan's first three years.

- ▶ Need equipment for your business? Buy and place it in service by year-end to qualify for up to \$500,000 of first-year expensing or 100% bonus depreciation.

- ▶ Review your investments and make your year-end sell decisions, whether to rebalance your portfolio at the lowest tax cost or to offset gains and losses.

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Understand “sunk costs” in making decisions

Emotions add zest to life. They propel us to our feet when our favorite running back scores a touchdown. They warm us at an inspirational concert or movie. But

in the realm of business and investing, emotions sometimes hinder good choices. In fact, businesses and individuals often let emotions dominate the decision-making process.

This is especially true when choices are based on “sunk costs.” Broadly defined, sunk costs are past expenses that are irrelevant to current decisions. For example, many firms hire consultants who sell and install software. In some cases, a company is still waiting – three or four years into the contract term – for a functional and error-free system. Meanwhile, costs continue to escalate. But are those costs relevant? Managers, especially those who initially procured the software and contractor, may reason that pulling the plug on a failed contract would be “wasting all that money we’ve spent.”

Not true. That money is “sunk”; it’s beside the point. Deciding to continue with a non-performing contract instead of staunching the flow of cash and changing course is irrational. It may be difficult to admit that a mistake was made. It may bruise the ego of the decision maker. But abandoning

a failed contract is often the wisest decision. The only relevant costs are those that influence the company’s current and future operations.

Irrelevant costs

Let’s say your firm hires a new salesman. You spend thousands of dollars sending him to training seminars. You assign mentors who take time from their busy schedules to provide on-the-job coaching and oversight. But despite your best efforts, the new hire isn’t working out. He doesn’t fit your firm’s culture; he doesn’t grasp the company’s goals and procedures; he doesn’t generate adequate revenues for the business. As a manager, what should you do? At some point, you may need to terminate that employee and start over with someone else. But what about all that time and money you spent training and mentoring the new salesman? Those costs are irrelevant; they’re “sunk.” You can’t get them back. So the best decision – as of today – may involve cutting your losses and starting anew.

Other examples of sunk costs may be found in the areas of product

research, advertising, inventory, equipment, investments, and other types of business expense. In each of these areas, companies spend money that can’t be recovered, dollars that become irrelevant for current decision making.

Sunk costs may also cloud one’s judgment in the arena of investing. In a completely rational world, people would base investment decisions on the bedrock of estimated future returns. Of course, that’s not the real world. Investors hold stocks in companies that are careening into bankruptcy, all the while refusing to sell because they’ve already committed so much money. Understandable, but foolish. Emotional, not rational. Throwing good money after bad won’t salvage a poor investment – or a poor investment decision. ♦



Act soon to save taxes (continued from page 1)

▶ If you’re charity-minded, consider giving appreciated stock that you’ve owned for over a year. You can generally deduct the fair market value and pay no capital gains tax on the appreciation.

▶ Another charitable possibility for those over 70½: Make a direct donation

of up to \$100,000 from your IRA to a charity. The donation counts as part of your required minimum distribution but isn’t included in your taxable income.

▶ Install energy-saving improvements (such as insulation, doors, and windows) in your home, and you might

qualify for a tax credit of up to \$500.

These possibilities for cutting your taxes are just the starting point. Contact us now for a review of your 2011 tax situation and tax-saving suggestions that will work best in your individual circumstances. ♦

Scams against the elderly: Know the danger signs to protect your family

News of yet another investment scam is alarming enough, but when the victim is elderly, the crime seems especially offensive. Senior

citizens are a favorite target of con artists for a variety of reasons. Here are some popular schemes to look out for.

► Precious metals

Scams take many forms, but those involving gold and precious metals are especially problematic right now. Buying gold is trendy, and it can appeal to a senior's desire for tangible security. Naturally, scammers will take advantage of this appeal. If someone you know is elderly and considering a gold-related investment, make sure they do their homework and work with a reputable company. Anyone pitching gold as a safety net against doomsday scenarios or hyperinflation should be carefully vetted.

► Investments

Of course, more traditional investment vehicles can also be dangerous. Life insurance, annuities, and other potentially complex deals can be marketed to prey on an elderly person's fear of running out of money. Investment advisors should only offer products suitable for the age, health, and financial wherewithal of their client. A perfectly legitimate investment can still be all wrong given certain circumstances.

► E-mail offers

By now, repetitive e-mail requests from some foreigner to wire funds to your bank account might seem almost comical, but to those who fall victim to a carefully crafted ploy, it is all too serious. Some very smart people – young and old – have been taken in by these types of scams, and when it happens to an elderly person, the fear of

looking incompetent often adds to the problem. Educate the senior in your life to always reject these offers.

► Pre-paid services

Not only do the elderly dread running out of money, they sometimes have an unhealthy concern for being a burden to others. This can manifest itself in attempts to prepay for certain services or signing up for strategies that will pay for bills owed at the time of death. Every so often, when the time comes to cash in these plans, the company is nowhere to be found, or the policy doesn't cover nearly as much as was expected. Like any other investment, the company behind the pitch should be scrutinized.



So, can you protect your senior from all the criminals out there? Probably not. But creating a fire wall around your loved one might call for a softer touch. Stay connected to their daily routine. Who are they spending time with? What are they reading? Become a stronger presence in their life, and the fears and loneliness that often initiate a wrong financial move could be reduced. ♦

MARK YOUR CALENDAR

JANUARY

17 – Due date for the fourth installment of 2011 individual estimated tax.

31 – Employers must furnish W-2 statements to employees. 1099 information statements must be provided to payees. (1099B and consolidated statements must be provided by February 15.)

31 – Employers must file 2011 federal unemployment tax returns and pay any tax due.

FEBRUARY

28 – Payers must file information returns (such as 1099s) with the IRS.*

29 – Employers must send W-2 copies to the Social Security Administration.*

MARCH

1 – Farmers and fishermen who did not make 2011 estimated tax payments must file 2011 tax returns and pay taxes in full.

15 – Deadline for calendar-year corporations to elect S status for 2012.

15 – 2011 calendar-year corporation income tax returns are due. ♦

*April 2 if filing electronically.



Review your beneficiary choices for needed changes

IRS expands spouse relief

If you file a joint income tax return with your spouse, you are considered “jointly and severally” liable for the payment of all taxes owed. The IRS can come after either you or your spouse for the entire amount of tax due, plus any penalties and interest due.

The law has “innocent spouse” rules that may limit an individual’s responsibility for unpaid taxes resulting from filing a joint return. If the “innocent spouse” can establish that he or she did not know, or have reason to know, that there was an understatement of tax when signing the joint return, relief can be requested. Under previous rules, this relief had to be requested within two years after collection proceedings were initiated by the IRS.

In a new 2011 ruling, the IRS has decided to eliminate the two-year time limit for requesting innocent spouse status under the “equitable relief” provision in the law.

New classification program

Companies that have had worker classification issues are being offered a settlement program by the IRS. The program, labeled the “Voluntary Worker Classification Settlement Program,” will let employers who previously misclassified employees as independent contractors make a minimal payment to settle the tax dispute.

The program will give eligible employers substantial relief from federal payroll taxes they may have owed for past periods. Employers must agree to pay just over 1% of wages paid to reclassified workers for the past year and to treat these workers as employees going forward. ♦

Are your beneficiary designations up to date? Do you even know which accounts have beneficiaries and

who you’ve designated? It’s easy to lose track. But it’s important to keep them current. Here’s why.

When you designate a beneficiary for an account, that person inherits the assets in the account, regardless of what your will might say. That’s why updating your will periodically might not be enough. Typically, you’ll have beneficiaries for each of your IRAs, your 401(k) or other retirement plans, annuities, and insurance policies.

Your designations could be out of date just because of life’s changes. Since you made your initial choices, you might have married, had children, or divorced. Some of the beneficiaries you chose could have died, divorced, or married. Their circumstances could have changed so you no longer want them to be the beneficiary.

Also, the tax laws change frequently, and they can have an impact on your choices. Choosing the wrong beneficiary, or failing to name a con-

tingent beneficiary, can affect the long-term value of your IRA assets after you die. That’s why it’s important to review your choices with tax consequences in mind.

Here’s how to update your designations. At a minimum, you should have copies of your beneficiary designations in one place. If you don’t, call the trustees of your retirement accounts and your insurance agent, and request copies.

Then review the documents and decide what changes you’d like to make. Make an appointment to review your decisions with your tax and estate planning advisor. Discuss matters such as naming secondary beneficiaries and naming your estate as a beneficiary (sometimes not a good idea).

Finally, send your changes to the account trustee, ask for a confirmation, and keep copies in your records. For any assistance you need, contact our office. ♦



CLIENT UPDATE: *This newsletter is issued quarterly to provide you with an informative summary of current business, financial, and tax planning news and opportunities. Do not apply this general information to your specific situation without additional details. Be aware that the tax laws contain varying effective dates and numerous limitations and exceptions that cannot be summarized easily. For details and guidance in applying the tax rules to your individual circumstances, please contact us.*