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tax IMPACT

Energy tax incentives

A conservation plan for your tax bill

Why there's nothing shabby about a Crummey trust

When are transportation expenses deductible?

Tax Tips

Small business stock, boosting cash flow and more

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A conservation plan for your tax bill

Over the last few years, Congress has created a variety of tax incentives for individuals and businesses that invest in energy-efficient appliances, cars, equipment and buildings. This year's stimulus bill — the American Recovery and Reinvestment Act of 2009 (ARRA) — expands many of these incentives and makes them even more valuable. But most of the energy tax breaks are temporary. So if you want to take advantage of them, begin planning now.

Incentives for individuals

ARRA expands energy tax credits for individuals and also relaxes limits on the amount of credit you can claim related to:

Home improvement. Under previous law, individuals could claim a personal income tax credit for energy-efficient property they installed in their principal residences through 2009. The amount of the credit was 10% of the cost of qualifying "building envelope" components — such as insulation, exterior windows (including doors and skylights) and certain roofs — plus a fixed dollar allowance for "qualified energy property," including certain circulating fans, boilers, furnaces, heat pumps and central air conditioners.

The amount and availability of alternative-fuel vehicle credits depend on several factors, including vehicle type, cost, weight and fuel economy.

The law set limits for certain subcategories of expenditures and also placed a $500 lifetime cap on the credit. It also provided that no more than $200 of the lifetime cap could be attributable to windows.

ARRA extends the credit through 2010. It also increases the amount of the credit to 30% of costs, eliminates caps on subcategories and increases the overall cap to $1,500 in expenditures during 2009 and 2010.

Alternative energy. ARRA gives a big boost to the existing tax credit for individuals who install alternative-energy equipment in their homes. The credit is equal to 30% of the cost (including labor) of qualifying solar energy equipment, geothermal heat pumps and fuel cell plants and is available through 2013; it also applies to residential wind energy equipment through 2012. Previously, the credit for solar and geothermal equipment was capped at $2,000, the credit for wind equipment was capped at $500 for each ½ kilowatt of capacity (up to $4,000), and the credit for fuel cell property was capped at $500 per ½ kilowatt of capacity.

Note that, in lieu of the tax credit, ARRA provides for a similar rebate, available through 2016, on the cost of certain renewable energy property. Further, for some

such property, ARRA eliminates the caps on which the credit or rebate may be calculated. This change is significant. A homeowner who invests $20,000 in a qualifying rooftop solar power system, for example, is now entitled to a $6,000 federal tax credit instead of $2,000 under previous rules.

However, these tax incentives are subject to a number of strict requirements. (See "Read the fine print" at right.) Before you invest in energy-saving equipment or materials for your home, consult with your tax advisor if you want to be sure you'll qualify for tax credits.

Incentives for businesses

Many of ARRA's energy tax incentives for businesses are directed at energy producers. For example, the act:

- Increases tax credits for commercial and retail alternative-fuel stations,
- Extends the tax credit for electricity produced from wind and other renewable sources,
- Expands the energy investment credit to include "qualified small wind energy property" and removes the credit cap, and
- Allows producers to elect to claim investment credits in lieu of production credits under certain circumstances.

The act also includes several other tax and nontax provisions designed to encourage the development and production of alternative-energy sources.

Commercial building deduction

Last year's Emergency Economic Stabilization Act extended the tax deduction for investments in energy-efficient commercial buildings through 2013. The deduction allows owners to write off the cost of qualifying depreciable property installed as part of the interior lighting, heating, cooling, ventilation or hot water systems, or as part of the building envelope.

The deduction is generally limited to $1.80 per square foot. Also, to qualify, the improvements must meet a 50% energy-reduction standard. Certain improvements that fail to meet this standard may be eligible for a partial deduction.

Alternative-vehicle incentives

Individuals and businesses may benefit from various tax credits for alternative-fuel vehicles, such as hybrids, fuel-cell vehicles and advanced lean-burn vehicles. ARRA also provides a credit for certain plug-in electric vehicles.

The amount and availability of these credits depend on several factors, including vehicle type, cost, weight and fuel economy. Individuals and businesses may also be eligible for tax credits for installing alternative-fuel storage, dispensing and recharging equipment.

Think long term

Cost, of course, is always an issue in today's struggling economy. But individuals and businesses that invest in energy efficiency find that this strategy can pay off in the long term by reducing energy costs up to 30% — and, in some cases, even more.

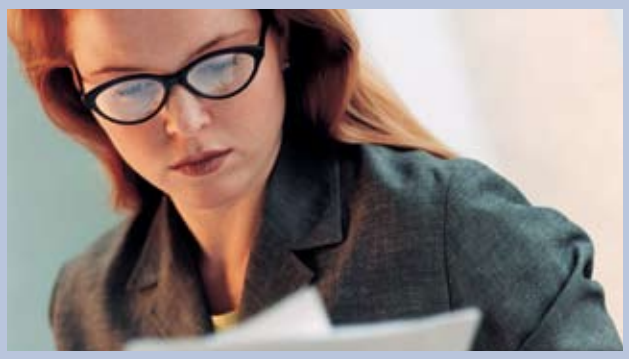
Read the fine print

Energy tax credits and other incentives provide valuable financial assistance to individuals and businesses looking to become more energy efficient. But don't assume that any investment you make in energy-saving products and materials will qualify for tax breaks.

Although the American Recovery and Reinvestment Act of 2009 (ARRA) expands many energy tax breaks, it also tightens the requirements that products must meet to be considered energy efficient. For example, windows, doors and skylights installed after Feb. 17, 2009, must have a U-factor and a Solar Heat Gain Coefficient (SHGC) less than or equal to 0.30. And gas, oil and propane water heaters must have an energy factor of 0.82 or more or a thermal efficiency of at least 90%.

In some cases, products that meet the standards of the federal government's Energy Star program are automatically eligible for tax credits. But in others, ARRA imposes stricter requirements. So the fact that a product bears the Energy Star label isn't a guarantee that it will qualify for a tax credit or other incentive.

To avoid unpleasant surprises, read the fine print before you buy and consult your tax advisor if there's any doubt.



Why there's nothing shabby about a Crummey trust

You probably know about the annual gift tax exclusion. It allows you to give up to $13,000 per year (the limit in 2009) tax free, to an unlimited number of people — and without using up any of your $1 million lifetime gift tax exemption. If you elect to split gifts with your spouse, you can give away up to $26,000 per recipient.

What you may not know is that the annual gift tax exclusion is available only for gifts of a present interest. Contributions to a trust ordinarily don't count, because a beneficiary's interest in a trust is considered a future interest. But what if you want to take advantage of the annual gift tax exclusion without simply handing over the cash to your children or grandchildren? One solution is a carefully designed Crummey trust.

What is it?

A Crummey trust (named for the court case that first approved the technique) is an irrevocable trust that's subject to withdrawal rights. By permitting beneficiaries to withdraw trust contributions during a specified period after they're made (usually 30 or 60 days), it's possible to convert a future interest into a present interest that qualifies for the annual gift tax exclusion.

For a Crummey trust to work, you must meet several requirements, including a notice requirement. Trust beneficiaries should receive a written notice (preferably by certified mail) explaining their withdrawal rights, the time limits for exercising those rights and the consequences of forgoing withdrawals.

A risk is that the IRS will challenge the trust as a tax-avoidance mechanism, deny the annual gift tax exclusion and present you with a bill for back taxes, penalties and interest.

What are the risks?

A Crummey trust can be a powerful estate planning tool, but it's not without risks. One potential issue is that your beneficiaries may choose to exercise their withdrawal rights. To achieve your estate planning objectives, you want your contributions to continue growing in the trust indefinitely.

At the same time, you can't prohibit your beneficiaries from withdrawing the funds: Crummey rights must be real to create a present interest. You can educate your family about the financial benefits of keeping assets in the trust, but you can't have an agreement that they won't exercise their withdrawal rights.

Another risk is that the IRS will challenge the trust as a tax-avoidance mechanism, deny the annual gift tax exclusion and present you with a bill for back taxes, penalties and interest. The IRS may claim that you

and your family have an understanding — express or implied — that the Crummey rights won't be exercised.

Families often run into trouble in this regard with irrevocable life insurance trusts (ILITs). A parent makes annual exclusion gifts to an ILIT and the trust immediately uses the funds to make premium payments. The IRS often challenges the arrangement, arguing that in such a situation the Crummey withdrawal rights are illusory because the beneficiary has no opportunity to withdraw the funds.

This problem can be minimized by keeping enough cash in the trust to cover any potential Crummey withdrawals or not making premium payments until the withdrawal period has expired or the trustee has received notification that the beneficiary waives his or her withdrawal right with respect to the funds.

What's the right withdrawal amount?

Setting the right withdrawal amount is critical to creating an effective Crummey trust. A specific dollar amount may not be appropriate because it doesn't reflect inflation adjustments to the annual gift tax exclusion amount. A better approach is to establish the withdrawal amount with reference to "the annual gift tax exclusion amount permitted by Internal Revenue Code Section 2503(b)."

It's also important to include limiting language to avoid running afoul of the "5 & 5 rule," which provides that a trust beneficiary's withdrawal rights shouldn't exceed the greater of $5,000 or 5% of the trust principal. If you violate the rule, it may trigger unexpected and unintended gift and income tax consequences.

What other provisions should you include?

When designing a Crummey trust, consider including language that will allow you some flexibility and help you avoid problems down the road. Here are a few ideas:

Allow trustees to modify withdrawal rights or deny them altogether for a particular beneficiary. Remember that the Crummey benefit is to the person making the gift, but he or she may prefer to forgo the ability to make the gift a present interest gift. There may be times, after all, when preventing withdrawals is more important than preserving the annual gift tax exclusion.

Preserve the parent's or guardian's power. You may provide that a minor's withdrawal rights may be exercised by a parent or legal guardian and that the parent or guardian is authorized to receive notices on the minor's behalf.

Make sure the withdrawal period is long enough. Typically, 30 days or more is appropriate. If the withdrawal period is too short, the IRS may argue that a beneficiary's withdrawal rights aren't genuine.

If your spouse is a trust beneficiary, provide that his or her rights are automatically terminated in the event of a divorce or legal separation. Note that in certain situations this may not be possible, but your estate planning advisor would be able to ensure that the drafting complies with local laws.

If the trust's beneficiaries include grandchildren or other young people, you may also need to include provisions or take other steps to minimize or eliminate your generation-skipping transfer tax liability.

Don't try this at home

A Crummey trust can be a very effective estate planning tool. It allows you to leverage the annual gift tax exclusion to transfer substantial amounts of wealth to your family tax free. However, like many estate planning tools, Crummey trusts contain several traps for the unwary. So before taking action, make sure you're fully informed about your financial situation as well as the advantages and disadvantages of this — or any — estate planning strategy. ◎

When are transportation expenses deductible?

Most workers and employers know that you generally can't deduct the cost of commuting between home and work — that's considered a personal expense. But there are certain situations in which commuting costs are deductible as transportation expenses.

When commuting isn't commuting

In some instances, you may deduct the expense of traveling between your residence and a work location. IRS Revenue Ruling 99-7 permits it under three circumstances:

1. The worker travels between his or her home and a temporary work location that is outside the metropolitan area where the taxpayer lives and normally works. This exception recognizes that it would be unreasonable to expect a worker to relocate his or her principal residence for a short-term job.

2. The worker travels between his or her home and a temporary work location, regardless of distance, and the worker has one or more regular work locations away from his or her home. This exception might apply, for example, to a consultant who sometimes travels directly from home to a client's site.

3. The worker travels between his or her home and a temporary or regular work location and the home qualifies as the worker's principal place of business. For example, a consultant who works out of his or her home and travels to client sites (temporary locations) while also renting conference space away from home (a regular location).

A key consideration for the first two exceptions is the meaning of "temporary work location." Notably, a job assignment of *indefinite* duration isn't considered temporary.

According to the ruling, absent facts and circumstances that indicate otherwise, a work site is temporary if employment there "is realistically expected to last (and does in fact last) for one year or less." However, if a job is initially expected to last one year or less but that expectation changes during the course of the job, it's treated as temporary until the date it becomes evident that the job will last more than one year.

Transportation as a fringe benefit

Qualified transportation fringe benefit programs offer tax benefits for both employers and employees. Employers that provide workers with transit passes, vanpool services or parking at or near the office or a mass-transit facility can deduct the expense while excluding the benefits from employees' wages (subject to the limits discussed below).

Qualified parking benefits can be provided in the form of a noncash benefit (such as the free use of a pay parking lot) or a taxable reimbursement of up to $230. This same cash reimbursement is also available for vanpool services or mass transit (or a combination of the two).

You're eligible to take advantage of both the parking and mass-transit/vanpool benefits, which would be applicable if, for instance, you had to pay to park at a commuter train station and also had to pay for the cost of taking the commuter train. If you do not participate in either of the benefits and use your bicycle to commute, you may be eligible for a $20 monthly benefit.

The road to tax savings

In the current economic crisis, every little bit of savings helps. So it pays for businesses and employees to become familiar with tax benefits that can help soften the blow of rising transportation costs. The benefits described above are subject to various rules and restrictions, so be sure to consult your tax advisor before acting. ◎

tax TIPS

A boost for small business stock

The American Recovery and Reinvestment Act of 2009 (ARRA) provides a big tax incentive for investors in qualified small business (QSB) stock, which generally includes stock in domestic C corporations with gross assets of $50 million or less. Ordinarily, taxpayers who hold QSB stock for at least five years are entitled to exclude 50% of the gain from its sale. ARRA increases the exclusion to 75% for QSB stock issued after Feb. 17, 2009, and before Jan. 1, 2011.

Tax law changes that improve your cash flow

In the current economic climate, maintaining good cash flow is one of the keys to survival. Fortunately, several 2009 tax law changes can give your cash flow a boost:

- The 50% first-year depreciation bonus has been extended to qualified assets acquired in 2009.
- The increased Section 179 small business expensing limits have been extended through 2009.
- The 2009 estimated tax payment requirements for many individuals who derive the majority of their income from a small business have been reduced.

Keep in mind that all of these tax breaks contain various restrictions and limitations. Contact your tax advisor for details.

Checking out the manufacturers' deduction

The manufacturers' deduction, also commonly referred to as the domestic production activities deduction or Section 199 deduction, allows a business to deduct up to 6% of its income from "qualified production activities," increasing to 9% next year. Although most people naturally associate this tax break with large manufacturing firms, it's available to a variety of businesses, including construction contractors, architects, engineers and software developers.

For sole proprietors and other small businesses, one obstacle to claiming the manufacturers' deduction is the fact that the deduction is limited to 50% of the company's W-2 wages attributable to qualified production activities. If you think the wage limitation is the only obstacle to qualifying for the deduction, you may want to consider hiring one or more employees.

Consider generation-skipping trusts

If you leave assets directly to your grandchildren (or others two or more generations below you), the bequest may be taxed twice: The transfer may be subject to both the estate tax and the generation-skipping transfer (GST) tax (at the same rate as the highest estate tax rate, which is 45% in 2009).

But you can transfer assets GST-tax free if you apply your GST tax exemption, which is $3.5 million in 2009. If you don't want to transfer assets directly to your grandchildren, you can apply your exemption to a generation-skipping trust. You may structure the trust so that it lasts for generations, with each succeeding generation receiving some income and use of the trust principal under certain circumstances, such as for medical emergencies or college tuition.

All future appreciation and accumulated wealth passes estate- and GST-tax free. But if your transfers to the trust exceed the GST tax exemption limit, there will be GST tax consequences.

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One of the cornerstones of ODMD's commercial tax practice is estate planning for closely-held business owners and high net worth individuals. While our tax professionals are experienced in initiating and implementing various sophisticated estate planning techniques that allow for discounted values of property transferred, utilizing the annual gift tax exclusion is a much more basic, yet very powerful, wealth transfer tool. In 2009, the annual gift tax exclusion is $13,000 per donee while married couples that elect to split gifts can increase their annual exclusion to $26,000 per donee. Qualifying gifts that are valued at or below the annual gift tax exclusion do not result in any gift tax, nor do they utilize any of the $1 million lifetime gift tax exemption. In addition, any future appreciation of the gifts is excluded from the donor's estate forever.

In order to qualify for the annual gift tax exclusion, the gift must be of a "present" rather than a "future" interest. This requirement is easily met with an outright gift of cash or property. However, many donors prefer that the donee obtain outright control of the gifted property at some future time (upon reaching a certain age) and make gifts to a trust for the benefit of the intended donee.

A trust can be formed to be revocable or irrevocable. Transfers to a revocable trust are not considered to be a gift and the assets within such a trust will be included in the grantor's estate for estate tax purposes. Such trusts are typically used to avoid probate upon the death of the grantor. Transfers made to an irrevocable trust are considered to be a completed gift, and thus the assets are out of the grantor's estate. However, transfers to an irrevocable trust are not generally considered to be a gift of a present interest and do not qualify for the annual exclusion. A happy medium can be reached if an irrevocable trust is formed that provides "Crummey" powers (named after a court case that approved the technique) to the beneficiaries. Gifts made to this type of trust will qualify for the annual gift tax exclusion. A Crummey power is a provision in the trust that allows each beneficiary to withdraw a certain amount from the trust for a specified time each year. If the beneficiary does not exercise their withdrawal power, the assets simply remain in trust. With proper education and counseling, the beneficiaries can understand the benefits of not exercising their withdrawal rights. However, the grantor cannot prevent a beneficiary withdrawal nor have some understanding with the beneficiaries that they may not exercise their withdrawal power.

An ODMD tax advisor can assist you in planning and implementing an irrevocable trust with Crummey powers. We can also ensure that the required beneficiary notification of withdrawal rights (Crummey letters) are properly worded and are provided to the beneficiaries on a timely basis. Please call us if you are interested in learning more about this or other estate planning techniques.

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Joe Bodan is the Director of Tax Services for ODMD. He has 27 years of experience providing federal, state and local, and international tax compliance and planning services for closely-held businesses and their owners, and high net worth individuals. He has been a member of the New York State Society of CPA's tax committees for state and local taxation, and closely-held and S corporations. Joe has been a featured speaker at seminars and has authored several tax articles affecting closely-held businesses and individuals.

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