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Published online Dec 7, 2010

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FINANCIAL SERVICES

Five Questions With: John Finnerty

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Back to the future? That's the overarching question that will be addressed during a forum on Thursday, Dec. 9, that will examine expiring federal tax legislation and newly enacted measures. The 8 a.m. event at the Providence Marriott Downtown will be hosted by Providence accounting firm Lefkowitz, Garfinkel, Champi & DeRienzo PC.

LGC&D principals John Finnerty, Richard DeRienzo, Jerrold Dorfman and Lynn O'Marra are scheduled to appear, along with Kimberly McCarthy, partner at the law firm Partridge, Snow & Hahn LLP.

Finnerty answered five questions for PBN ahead of the event.

PBN: There has been a lot of talk about whether the Bush tax cuts will in fact be allowed to expire at year's end. Does this uncertainty



PHOTO COURTESY LGC&D

"NO ONE methodology is right for everyone – we are addressing each situation individually," said John Finnerty, principal at LGC&D.

right now cause problems for you and your clients going into the new tax year?

FINNERTY:

It has created significant uncertainty in tax planning for 2010, but also for 2011 and beyond. If Congress does nothing and the Bush tax cuts expire, there will be an automatic tax increase across the board. The highest tax rate, currently at 35 percent, will increase to 39.6 percent. Long-term capital gains tax rates will go from 15 percent to 20 percent.

It has been a long-standing tax adage to defer income and accelerate deductions, whenever possible, to defer the payment of tax to a future date. In this environment, the question becomes does one accelerate income into 2010 and defer deductions into 2011. While clients never like to recognize income earlier than they absolutely have to, we have and may continue to recommend that certain income be accelerated (if possible) into 2010. Examples of income that can be accelerated include the gain recognizable under installment sales that occurred in 2010. It may, under the right circumstances, be advantageous for the taxpayer to recognize all the gain from the sale in 2010 rather than deferring the gain recognition until the cash is collected in future years. Additionally, 2010 is the first year that allows any taxpayer to convert an IRA to a Roth IRA regardless of income levels. The IRS allows the tax on the conversion to be paid in 2011 and 2012 – in the alternative a taxpayer may elect to include in income in 2010. The factor that will make whatever decision that is made the right decision will be what Congress does with tax legislation in the next several months.

With the “sunset” of the Bush tax cuts, there are a lot of other “moving parts,” including the return of the phase-out of itemized deductions and reductions in personal exemptions for taxpayers with adjusted gross incomes over certain thresholds. These items will potentially affect taxpayers in 2011, by potentially decreasing their itemized deductions or exemptions and increasing their effective tax rate through the loss of these deductions.

We are working with our clients to help them see how their individual situation will be affected by the various alternative endings to this process. No one methodology is right for everyone – we are addressing each situation individually.

PBN: What other provisions in the tax law are set to expire or resume that are getting less attention? The estate tax comes to mind.

FINNERTY:

The estate tax is a major item. I don't believe that anyone would have believed that during 2010 there would be no federal estate tax. As with the other provisions, if Congress does nothing the estate tax will be reinstated in 2011. However, the estate-tax exemption in 2011 will be \$1 million (down

from \$3.5 million in 2009) and the top estate-tax rate will be 55 percent (up from 45 percent in 2009).

Other items that perhaps receive less attention but have the potential to have a major impact include:

- The tax on qualified dividends increasing from 15 percent to an individual's marginal ordinary income tax rate (a maximum of 39.6 percent)
- The top gift tax rate will increase to 55 percent, up from 35 percent in 2010
- The return of the "marriage penalty" in the tax brackets and standard deduction.

There are a few items that, although not part of the "sunset" provision of the Bush tax cuts, have expired in 2010 and are awaiting an extension from Congress. These items include:

- Research and development credit
- The tax-free treatment of qualified charitable distributions from IRAs
- Deduction for certain expenses of elementary and secondary school teachers
- Additional standard deduction for state and local real property taxes
- Deduction for state and local general sales tax
- Exclusion of up to \$2,400 of unemployment compensation from gross income
- Alternative minimum tax exemption patch

PBN: Is the IRS still going forward with plans to require 1099 forms for any payments to vendors and service providers that exceed \$600 in a year?

FINNERTY:

There are really two aspects of changes relating to Form 1099 reporting – one takes effect in 2011 and the other in 2012.

The first affects recipients of rental income and requires all payments made to service providers of \$600 or more in the course of earning rental income to be reported on an information return (i.e., 1099-MISC) beginning for payments made after Dec. 31, 2010. This means that landlords now are required to get a Form W-9 from all their service providers (such as plumbers, painters, accountants, landscapers) if the amount paid to them is greater than \$600. We are recommending that all landlords get a Form W-9 (which provides the employer identification number) from all service providers now rather than waiting to see if the payments total greater than \$600 at the end of 2011.

The second and potentially far-sweeping provision will affect all taxpayers engaged in a trade or business. For payments made after Dec. 31, 2011, a business must file an information return (i.e., Form 1099-MISC) for all payments (goods and services) aggregating \$600 or more in a calendar year to a single payee (including corporations). This means that if we as a CPA firm

purchase office supplies from Staples and, in the aggregate for the year, the amount is over \$600, we need to send Staples a Form 1099. Also, if we purchase computers from Dell and the aggregate for the year is over \$600, we need to send a Form 1099.

This second requirement will put an undue administrative hardship on all businesses to have to prepare and file a significantly larger number of Forms 1099.

In addition, the IRS has also increased the penalties for failure to file or late filing of information returns to be filed after Dec. 31, 2010. The per-return penalty amount is doubled and the maximum limits are increased.

There was recently introduced legislation into the Senate by the Senate Committee Finance Chair Max Baucus, D-Mont., that would have repealed the expanded Form 1099 reporting requirements. However, on Nov. 29 the Senate failed to gain the necessary votes to have the legislation continue. There are many Congressional opponents of the expanded Form 1099 reporting requirements, and there is sure to be another attempt to repeal the requirements. Stay tuned.

PBN: What about other changes coming in future years? What upcoming tax provisions look like they might be a big headache for business owners or individuals?

FINNERTY:

There are a few items that taxpayers should be aware of that will not affect them for a few years, but they need to know to enable proper planning, if any.

Items that take effect in 2013, include:

- An additional 0.9 percent Medicare tax applies to wages and self-employed income for married taxpayers filing a joint return in excess of \$250,000; \$125,000 for married taxpayers filing separate returns; and \$200,000 in all other cases (i.e., single, head-of-household)
- A 3.8 percent surtax on unearned income of higher-income taxpayers (individuals, estates and trusts);

this tax is applied annually in an amount equal to 3.8 percent of the lesser of net investment income for such taxable year, or the excess of: (a) the modified adjusted gross income for such taxable year, over (b) the threshold amount. For this purpose, the threshold amount is \$250,000 for joint return, \$125,000 for a married individual filing a separate return, and \$200,000 for all others

- Unreimbursed medical expenses will be deductible by taxpayers under age 65 only to the extent that they exceed 10 percent of adjusted gross income. If over age 65, a 7.5 percent threshold applies through 2016 and thereafter a 10 percent threshold would apply

Items that take effect in 2014 include:

- A penalty on large employers not offering affordable health insurance
- Individuals not carrying health insurance face a penalty
- New information reporting of employer-provided health coverage

- Excise tax on health insurance providers

PBN: What about changes for the better?

FINNERTY:

Yes. Although there has been no “blockbuster” legislation introduced and enacted in 2010 (e.g., dealing with the Bush tax cuts), there have been a number of other pieces of legislation that have varying provisions.

The first piece of tax legislation passed in 2010 was the Hiring Incentives to Restore Employment Act. This act provides incentives to employers to hire qualified individuals who may have been unemployed for a period of time. These incentives range from an exemption for the employer’s portion of the Social Security tax on wages to a credit for retaining these hired employees for 52 consecutive weeks.

The second piece of legislation was the Patient Protection and Affordable Care Act of 2010. This legislation expands the exclusion for reimbursements for medical care expenses under an employer-provided health plan to any child of an employee who has not attained age 27. The act also provides a small employer health insurance credit to a qualified small employer. A qualified small employer is an employer with no more than 25 full-time equivalent employees and has annual full-time equivalent wages that average no more than \$50,000. The maximum credit is 35 percent of the employer’s premium expenses.

The third piece of legislation is the Small Business Jobs Act of 2010. This legislation provides a number of provisions that may be beneficial to businesses, including:

- The immediate expensing of capital investment (so-called “Section 179” depreciation) of up to \$500,000 of the cost of qualifying property (i.e., machinery, equipment, furniture, computers, etc)
- An additional first-year depreciation deduction of up to 50 percent of the cost of the qualifying property placed in service by Dec. 31, 2010
- An election for a taxpayer to deduct up to \$10,000 of start-up expenditures in the taxable year in which the active trade or business begins
- For taxable year 2010 and following, a self-employed person may deduct health insurance premiums and cost in computing net earnings from self-employment for purposes of the self-employment tax
- A 100 percent exclusion (with certain limits) for capital gains recognized on the sale of small business stock held more than 5 years and acquired after Sept. 27, 2010, and before Jan. 1, 2011.



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