

Cohen Smith & Company, P.A.

NEWSLETTER



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June 2011

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Assisting Grandchildren with College Costs

Contributing to a Section 529 college savings program is a great way for grandparents to help their grandchildren pay for college. It is also a great way to remove assets from the grandparent's estate without paying estate tax. As an added feature, money in a 529 plan owned by a grandparent is not assessed

by the federal financial aid formula when qualifying for student aid.

Grandparents, as well as other taxpayers, have a unique opportunity for gifting to Section 529 college savings plans by contributing up to \$65,000 at one time, which currently represents five years of gifts at \$13,000 per year (\$13,000 is the annual gift tax exclusion amount for 2011.)

A married couple who elects gift-splitting can contribute up to double that amount (\$130,000 in 2011) to a beneficiary's 529 Plan account(s) with no adverse federal gift tax consequences.

Example: Electing to spread a 529 Plan gift over five years.

In 2011, Linda contributes \$75,000 to a 529 Plan account for the benefit of her grandson, James. She makes no other gifts to James in 2011. Because the gift exceeds the \$13,000 annual gift tax exclusion, Linda elects to account for the gift ratably over five years beginning with 2011. Only \$65,000 (five times the current annual gift tax exclusion) is eligible for the election; therefore, Linda is treated as having made an excludible gift of \$13,000 in years 2011–2015, and a taxable gift of the remainder (\$10,000) in 2011.

See the related article on page four for more information on nontaxable gifts, and contact us if you have questions

Deducting Interest on Home Loans

The political debate on tax reform touches many topics, including the federal tax deduction for interest on home loans. There is no way to determine if this deduction will continue or at what level, but we thought it would be a good time to review current federal law on deducting residential interest.

Interest paid on qualified residence debt is deductible, but limitations apply. Qualified residence debt can be either (a) home acquisition indebtedness, or (b) home equity indebtedness. Qualified residence interest expense incurred on up to \$1 million (\$500,000 for married filing separately) of home acquisition indebtedness is fully deductible for regular tax purposes as an itemized deduction. Taxpayers generally can deduct interest on up to \$100,000 (\$50,000

for married filing separately) of home equity indebtedness. However, there are restrictions on the deductibility of qualified residence and home equity interest for AMT purposes. Mortgage interest is only deductible when paid by the taxpayer who is the legal or equitable owner of the property and the property is subject to a legally binding mortgage. Thus, a taxpayer cannot deduct interest he or she pays on the mortgage of another person. This may occur, for example, if parents make mortgage payments for their adult children. Similarly, a taxpayer who holds a mortgage generally cannot deduct the interest if it is paid by another person.

A qualified residence (for determining if the underlying debt is qualified residence debt) can be the taxpayer's principal residence and one other residence selected by the taxpayer for the tax year. In other words, if the taxpayer has several vacation homes in addition to a principal residence, the taxpayer can designate a different vacation home as the second qualified residence for different tax years. A residence is defined as (a) a house, (b) a condominium, (c) a mobile home, (d) a boat, (e) a house trailer, or (f) other property that under all the facts and circumstances can be considered a residence. Vacant land used for occasional camping does not qualify as a residence.



A residence under construction can be treated as a qualified residence for up to 24 months, but only if the residence actually becomes a qualified residence when it is ready for occupancy and construction is financed with mortgage debt. However, the land a home is constructed on does not qualify as a residence under the above rule until construction begins. Interest on debt to acquire a lot that is incurred before construction begins would be personal interest.

However, that interest could be deductible if a home equity loan is used to acquire the lot.

When Are Gifts Taxable?



The new federal estate and gift tax provisions signed into law late last year have received considerable attention and may have created some confusion concerning the taxability of gifts. So, we thought it would be a good time to review some basic information on the annual gift tax exclusion.

Most gifts are not subject to the gift tax. For example, there is usually no tax when you make a gift to your spouse or a charity. If you make a gift to someone else, the gift tax usually does not apply until the cumulative value of the gifts you give to that person during the year exceeds the annual gift tax exclusion. In 2011, the annual federal gift tax exclusion amount is \$13,000. A federal gift tax return generally does not have to be filed unless you give someone, other than your spouse or a qualifying charity, money or property worth more than the annual gift tax exclusion.

If a federal gift tax return is required (i.e., gift of more than \$13,000), typically no tax is due. Rather, a portion of the giver's federal estate tax credit (exempts \$5,000,000 of estate assets in 2011), if not previously used, is reduced. If gift tax is due, it typically will be paid by the person making the gift. The person receiving the gift does not pay federal gift tax or federal income tax on the value of the gift received. However, the person making the gift will not be able to deduct the value of the gift on his or her federal tax return, other than gifts that are deductible charitable contributions.

Thus far, we have indicated that gifts (a) for not more than the annual exclusion during the calendar year, (b) made to your spouse,

or (c) made to a qualifying charity, generally are not subject to the federal gift tax. In addition to these provisions, tuition or medical expenses you pay directly to an educational or medical institution for someone else are not subject to federal gift tax, either.

Caution: You cannot first give the money to an individual for the purpose of paying the end recipient. To avoid federal gift tax liability, the money must be paid directly to the institution.

Gift-splitting is a technique available to married persons wanting to individually make a non-taxable gift of up to \$26,000 in a single year. For split gifts, the donor's spouse must elect to split the gift with him or her. The gift is considered to be made half by the donor and half by the spouse. When a taxpayer elects to split a gift, a federal gift tax return must be filed to show that the spouses agree to use gift-splitting, even if the split gift is less than the annual exclusion (\$13,000 in 2011).

Finally, for the above rules to apply, gifts must qualify as a gift of a "present interest." This normally means an unrestricted right to the immediate use, possession, or enjoyment of property or the income from property. Therefore, gifts of interests in limited partnerships, LLCs, trusts and other entities with potential restriction requires special analysis.

Application of and aspects concerning the gift tax, including the impact of the \$5 million unified estate and gift tax exclusion (mentioned earlier), can be daunting. So, please contact us to discuss the tax aspects of gifting or any other tax compliance or planning issue.



TAX CALENDAR

JUNE 2011

June 10

Employees who work for tips. If you received \$20 or more in tips during May, report them to your employer. You can use Form 4070.

June 15

Individuals. Make a payment of your 2011 estimated tax if you are not paying your income tax for the year through withholding (or will not pay in enough tax that way). Use Form 1040-ES. This is the second installment date for estimated tax in 2011. For more information, see Publication 505.

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in May if the monthly rule applies.

Corporations. Deposit the second installment of estimated income tax for 2011. A worksheet, Form 1120-W, is available to help you estimate your tax for the year.

JULY 2011

July 11

Employees who work for tips. If you received \$20 or more in tips during June, report them to your employer. You can use Form 4070.

July 15

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in June if the monthly rule applies.