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TAX AND BUSINESS ADVISOR

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TAX AND BUSINESS Alert™

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Used Vehicle Donation Rules

There are strict rules for charitable contributions of used motor vehicles, boats, and airplanes that apply to donations valued at over $500. If these rules are not met, a taxpayer cannot claim a charitable deduction. This article explains how the rules work and how taxpayers can verify their donation of a used vehicle, boat, or plane.

The allowable deduction depends on how the donated asset is used by the charity. If the organization sells the asset without using it significantly for charitable purposes and/or making meaningful improvements, the taxpayer's deduction is generally limited to the gross proceeds from the sale. So, when this general limitation rule applies, the fair market value (FMV) of the donated asset is irrelevant, even if it exceeds the sales proceeds.

However, there are two exceptions to the sales-proceeds limitation rule. The first occurs when the charity sells or gives the taxpayer's donated vehicle to a needy individual for less than FMV in furtherance of the organization's charitable purpose. The second exception is available when the charity keeps the taxpayer's donated vehicle and uses it significantly for charitable purposes or makes meaningful improvements before ultimately selling it. When one of these exceptions applies, the taxpayer generally can deduct the full FMV of the vehicle as of the contribution date.

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The tax law includes requirements for charities to substantiate—via written acknowledgments supplied to donors—all manner of things related to contributions of used motor vehicles, boats, and planes. Most charities will comply by issuing the taxpayer a copy of IRS Form 1098-C (Contributions of Motor Vehicles, Boats, and Airplanes). If so, this form contains the all-important gross sale proceeds amount, which usually equals the amount the taxpayer can deduct. The charity must also indicate if one of the two exceptions explained above applies (which means you may be entitled to a larger deduction) and add information substantiating the exception. The taxpayer cannot claim a deduction above $500 unless the charity supplies him or her with Form 1098-C.

The information contained in this newsletter was not intended or written to be used and cannot be used for the purpose of (1) avoiding tax-related penalties prescribed by the Internal Revenue Code or (2) promoting or marketing any tax-related matter addressed herein.

Tax Calendar

July 15—If the monthly deposit rule applies, employers must deposit the tax for payments in June for social security, Medicare, withheld income tax, and nonpayroll withholding.

July 31—If you have employees, a federal unemployment tax (FUTA) deposit is due if the FUTA liability through June exceeds $500.

—The second quarter Form 941 (Employer's Quarterly Federal Tax Return) is also due today. (If your tax liability is less than $2,500, you can pay it in full with a timely filed return.) If you deposited the tax for the quarter in full and on time, you have until August 11 to file the return.

August 15— If the monthly deposit rule applies, employers must deposit the tax for payments in July for social security, Medicare, withheld income tax, and nonpayroll withholding.

September 15—Third quarter estimated tax payments are due for individuals, trusts, and calendar-year corporations.

—If a six-month extension was obtained, calendar-year corporations should also file their 2007 income tax returns by this date.

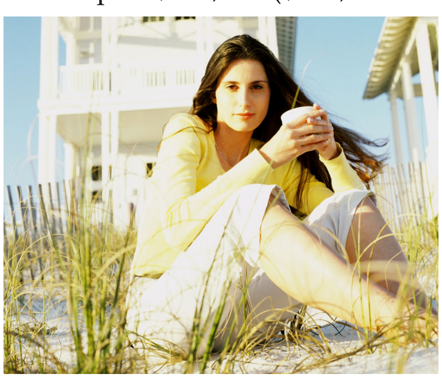
— If the monthly deposit rule applies, employers must deposit the tax for payments in August for social security, Medicare, withheld income tax, and nonpayroll withholding.

Financial Websites

The University of Pennsylvania offers an extensive directory of finance and investment websites for your personal use at **http://gethelp.library.upenn.edu/guides/business/financeandinvestment.html**. The directory lists websites for market analysis, bonds, corporate financials, mutual funds, and numerous other investment topics.

Surviving Spouse Home Sale Exclusion Extension

Married taxpayers filing jointly can generally exclude from federal taxation up to $500,000 ($250,000 for unmarried taxpayers) of the gain from the sale or exchange of their residence. To be eligible for the exclusion, these taxpayers must have owned the residence and used it as their principal residence for at least two years of the five-year period ending on the date of the sale or exchange.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Prior to 2008, an unmarried individual whose spouse is deceased on the date of the sale or exchange, could still exclude up to $500,000 from federal taxation if the sale occurred in the year of the deceased spouse's death and certain other requirements were met. However, for sales or exchanges occurring after the year in which the spouse died, the exclusion for the surviving spouse was limited to $250,000.

But a provision of the 2007 Mortgage Relief Act extends the period for the surviving spouse to benefit from the $500,000 exclusion for sales or exchanges after December 31, 2007. Now, a surviving spouse can exclude up to $500,000 if the sale occurs not later than two years after the date of the death of the spouse and the ownership and use requirements are satisfied at the date of death. This allows a surviving spouse additional time to market and sell his or her residence and be able to use the higher $500,000 exclusion.

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Health Savings Account (HSA) Basics

Most of us like to take advantage of every available tax break. So, if you are eligible for a Health Savings Account (HSA), now might be a good time to start one. HSAs operate somewhat like the flexible spending accounts (FSAs) that some employers currently offer their employees who want to defer a portion of their pay on a pretax basis to be used later to reimburse themselves for out-of-pocket medical expenses. Unlike an FSA, however, whatever's left in the HSA at year-end can be carried over to the next year. In addition, HSAs can be set up by the self-employed or even a nonworking spouse.

Naturally, there are a few catches. The most significant requirement is that HSAs are only available to individuals who carry health insurance coverage with relatively high annual deductibles. By that, we mean their health insurance coverage must come with at least a $1,100 deductible for single coverage or $2,200 for family coverage. However, for many self-employed individuals, small business owners, and employees of smaller companies, these thresholds won't be a problem. In addition, it's OK if the insurance plan doesn't impose any deductible for preventive care (such as annual checkups).

The other requirements for setting up an HSA are that an individual can't be eligible for Medicare benefits or claimed as a dependent on another person's tax return. Individuals who can meet these requirements can make tax deductible HSA contributions for 2008 of up to $2,900 for single coverage or up to $5,800 for family coverage. When an employer contributes to an employee's HSA, such as in the case of a closely held business, the contributions are exempt from federal income, social security, Medicare, and FUTA taxes.

An account beneficiary, who is age 55 or older by the end of the tax year for which the HSA contribution is made, may make a larger deductible contribution. Specifically, the annual contribution limit is increased by $900 for 2008.

An HSA generally can be set up at a bank, an insurance company, or any other institution the IRS deems suitable. The HSA must be established exclusively for the purpose of paying the account beneficiary's qualified medical expenses. These include uninsured medical costs incurred for the account beneficiary, spouse, and dependents.

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However, for HSA purposes, health insurance premiums don't qualify; neither do higher deductibles or higher out-of-pocket maximums for out-of-network benefits.

The tax rules for HSAs are quite similar to those for IRAs. For example, individuals can make HSA contributions for a particular tax year as late as April 15 of the following year. In addition, federal-income-tax-free rollovers from one HSA into another are permitted (but only once per 12-month period).

HSAs seem like a match made in heaven for those currently paying health care costs out of their own pocket using after-tax dollars. Provided you have (or are willing to change to) health insurance coverage that qualifies as a high-deductible policy, there doesn't seem to be a downside to setting up an HSA, because unused amounts at year-end carry over to later years. Setting up an HSA should allow you to pay your medical expenses with pretax dollars. For example, for those in the 28% tax bracket, this is like getting a 28% discount on their medical expenses. For business owners who are covered by health insurance through the company, having the company fund the HSA can make sense.

This is just a quick overview of the HSA rules. Please call us if you'd like to know more about whether an HSA is right for you or to discuss any other tax compliance or planning issue.

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Removing Economic Stimulus Deposits from Tax-deferred Accounts

The Economic Stimulus Act provides a tax rebate to eligible individuals based on their filing status and income. Taxpayers who indicated on their 2007 federal tax return that refund amounts should be direct deposited into a specific account will have their economic

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stimulus payment direct deposited to that same account. That account could be a checking or saving account or a tax-favored account such as an IRA. However, taxpayers who elected to direct deposit their 2007 refund into more than one account, will be mailed an economic stimulus check.

The objective of the economic stimulus checks was to put money in the hands of consumers to be spent and, therefore, "stimulate" the economy. Funds sitting in an IRA or other tax-deferred account are being saved, not spent, and will not directly stimulate the economy.

To alleviate this situation, the IRS recently announced that economic stimulus payments direct deposited into IRAs and other tax deferred accounts may be withdrawn tax-free and penalty-free. This relief is designed to help taxpayers who may have been unaware that by choosing direct deposit for their entire regular tax refund, they were also choosing to have their stimulus payment direct deposited as well. Withdrawals may be made from these tax-favored accounts in amounts that are less than or equal to the direct deposited stimulus payment. Thus, for example, a taxpayer whose $1,200 stimulus payment was direct deposited into his or her IRA can take out up to $1,200 from the IRA, tax-free and penalty-free.

To qualify for the recently announced relief, funds must be taken out of the tax-deferred account by April 15, 2009, for most taxpayers or by October 15, 2009, for those who obtain tax filing extensions. Without this relief, taxes, penalties, and other special rules would apply to amounts removed from these accounts. Regular tax refunds are not eligible for this relief.

Please call us if you have questions about removing economic stimulus payments from an IRA or other tax-deferred account, or any other questions about tax return preparation or planning.

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