Halcolm Bard
Certified Public Accountant & Consultants

TAX AND BUSINESS ADVISOR

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TAX AND BUSINESS Alert™

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Reporting and Deducting Director's Fees and Expenses

Reporting director's fees and expenses accurately should mitigate any unwanted attention from the IRS, and less attention from the IRS is almost always beneficial. As background, compensation paid to directors of a business is deductible if it is paid for services actually rendered (i.e., the directors actually attended the meetings) and is reasonable in amount. An employee who is also a director may be entitled to receive fees for attending directors' meetings in addition to compensation as an employee. Directors' fees are reported by the business to the IRS and to the directors as miscellaneous income in the year paid.

Fees paid for attending directors' meetings and for services as a director represent earnings from self-employment. Therefore, a director is liable for self-employment (SE) tax in the year fees are received.

Example: Reporting director's fees.

Jim serves as a director of T Corporation (T) and has no other source of SE income. He attends the annual directors' meeting held on December 15, 2008. On January 15, 2009, T pays Jim a director's fee of $700. Since T must report the fee in the year paid, it will report the $700 fee to Jim as 2009 SE income.

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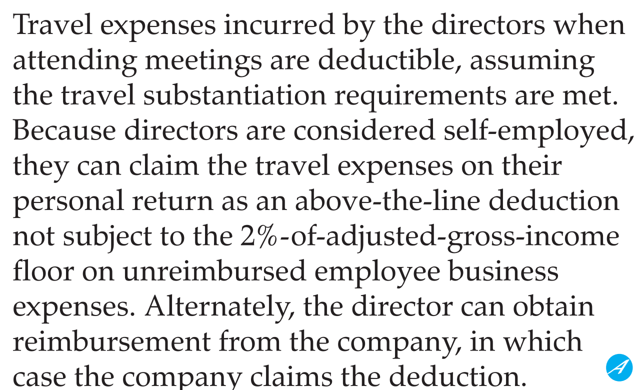
Jim's 2008 return does not reflect SE tax liability because he is not required to report any SE income that year. However, Jim's 2009 return will show an SE tax liability because he must report the $700 director's fee received on January 15, 2009, as SE income.



Travel expenses incurred by the directors when attending meetings are deductible, assuming the travel substantiation requirements are met. Because directors are considered self-employed, they can claim the travel expenses on their personal return as an above-the-line deduction not subject to the 2%-of-adjusted-gross-income floor on unreimbursed employee business expenses. Alternately, the director can obtain reimbursement from the company, in which case the company claims the deduction.

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.

Retirement, Gift, and Estate Planning Limitations for 2009

New limitations are effective in 2009 for some types of retirement plans, gifts, and estate taxes. First of all, the IRA contribution limit is unchanged at $5,000 in 2009 (for individuals with at least that much in earned income). In addition, the IRA catch-up contribution amount for taxpayers age 50 and older by year-end remains at $1,000. So, a *qualified* individual can save up to $6,000 in an IRA while a *qualified* married couple can save up to $12,000, as long as they have at least that much in earned income and both are age 50 or more by year-end.

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Qualified retirement [401(k), 403(b), and 457] plan deferral (contribution) limits increase by $1,000 to $16,500 in 2009. Taxpayers age 50 or more by year-end are *eligible* to make an additional catch-up contribution of up to $5,500, an increase of $500 from last year. So, it is possible for an eligible employee to sock away up to $22,000 ($16,500 + $5,500) in a qualified plan this year. SIMPLE plan deferral limits increase by $1,000 to $11,500 in 2009. Catch-up contributions of $2,500 (unchanged from the prior year) can also be made to a SIMPLE plan by taxpayers who are age 50 or more at year-end.

The annual gift tax exclusion increases by $1,000 in 2009 to $13,000, or $26,000 when a married couple makes a gift-splitting election. The estate tax exclusion increases by $1.5 million to $3.5 million this year. The estate tax exclusion can be used to bequeath up to a total of $3.5 million to nonspouse beneficiaries and escape taxation. (Transfers to a spouse can generally be made estate tax-free using the unlimited marital deduction.)

Help Your Grandchildren Pay for College

Contributing to a 529 plan is a great way for grandparents to help their grandchildren pay for college. It is also an effective way to remove assets from their estate without paying the gift tax. Individuals can contribute up to $65,000 (the $13,000 annual gift tax exclusion times five years) per person to a 529 plan without incurring gift tax, and they still maintain control of the account. As an added feature, money in a 529 plan owned by a grandparent is not assessed by the federal financial aid formula.

Housing Credit Information

The National Association of Home Builders provides a comprehensive overview of the first-time homebuyer tax credit at *www.federalhousingtaxcredit.com*. This website offers aspiring homebuyers information on the tax credit at a glance and a lengthy list of frequently asked questions and responses about the credit. In addition, this website offers links to home buyer resources such as the Departments of Veterans Affairs and Housing and Urban Development.

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Required Minimum Distributions Waived for 2009

Taxpayers can be subjected to an onerous excise tax if they take less than the required minimum distribution (RMD) from their retirement plan each year. A 50% excise tax can be imposed on the difference between the RMD from a qualified retirement plan and the actual amount distributed during a tax year. RMDs are generally required to begin by April 1st of the year following the year a plan participant reaches 70½. Plans affected include pension plans, profit-sharing plans, stock bonus plans, Section 403(a) annuities, tax-sheltered annuities, traditional IRAs, SEP IRAs, and SIMPLE IRAs. Simply stated, if you withdraw less than the required amount from one of these plans, a serious penalty can be imposed by the IRS. (Note, however, that during the owner's lifetime, Roth IRAs are not subject to the minimum distribution rules.)

Fortunately, Congress recently provided relief from the RMD requirements for 2009. The Worker, Retiree, and Employer Recovery Act of 2008 (Recovery Act) contains a provision waiving RMDs from IRAs and defined contribution plans, including 401(k), 403(b), and state-sponsored 457 plans in 2009. It does not otherwise change the RMD rules as stipulated by law. This relief applies to lifetime distributions to employees and IRA owners and after-death distributions to beneficiaries.

The waiver is only for 2009 RMDs. It does not apply to 2008 RMDs, even those permitted to be made in 2009 because the individual's required beginning date is April 1, 2009 (e.g., individuals who turned age 70½ in 2008). Failure to make all or part of the 2008 RMD could result in a 50% penalty tax on the unwithdrawn amount. Absent another law change, RMDs will once again be required in 2010.

For account owners whose required beginning date is April 1, 2010 (e.g., individuals who turn age 70½ in 2009), the first year for which an RMD is due is 2009. Under current law, their 2009 RMD doesn't have to be made until April 1, 2010, the required beginning date. Now, thanks to the Recovery Act, no RMD is required for 2009, and thus no distribution will be required by April 1, 2010. However, the provision does not change the individual's required beginning date. Therefore, the 2010 RMD will be required to be made no later than December 31, 2010. Also, if the individual dies on or after April 1, 2010, post-death RMDs for the individual's beneficiary will be determined using the rules applicable if the owner died on or after the required beginning date.

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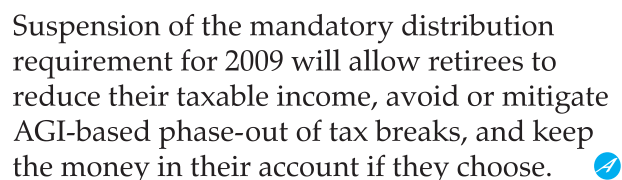
Example: 2009 RMD waiver.

Wilma, a traditional IRA owner, attains age 70½ in 2009 and her required beginning date to take distributions is April 1, 2010. Prior to the Recovery Act, the first year for which Wilma would have to take an RMD from her IRA would be for 2009 (it would have to be taken by April 1, 2010). Under the Act, no RMD is required for 2009, and thus no distribution will be required by April 1, 2010. However, because the Recovery Act does not change the required beginning date for purposes of determining the RMD for calendar years after 2009, Wilma's RMD for 2010 must be made no later than the last day of calendar year 2010. Should Wilma die on or after April 1, 2010, the RMD for Wilma's beneficiary will be determined using the rules that apply where an IRA owner dies on or after the required beginning date.



Suspension of the mandatory distribution requirement for 2009 will allow retirees to reduce their taxable income, avoid or mitigate AGI-based phase-out of tax breaks, and keep the money in their account if they choose.

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The Disposition and Tax Aspects of Life Insurance Proceeds

Individuals generally receive life insurance proceeds because they are a named beneficiary of a relative's or another individual's life insurance policy. If the beneficiary is still living at the time of the insured's death, the proceeds are paid to him or her. When the beneficiary is not living at the time of the insured's death, the proceeds are payable to his or her probate estate.

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Occasionally, an estate receives life insurance proceeds when it is named as the beneficiary of an insurance policy or when no beneficiary has been named upon the insured's death. A trust would only receive insurance proceeds when it has been named as the beneficiary.

Generally, life insurance proceeds paid at the insured's death are not included in gross income. However, most insurance companies will pay interest on proceeds between the date of death and actual payment of the proceeds. While the proceeds are not taxable, any interest payments are included in gross income. When the proceeds are paid in installments, they are prorated over the payment period. As payments are made, the portion of each payment that represents interest is included in gross income, while the portion that represents proceeds is excluded.

A different situation exists when the executor surrenders a policy on a living insured. For example, the deceased may have owned a policy in which another person is the insured. Upon the decedent's death, the policy becomes a probate estate asset (since the deceased was the owner) but no proceeds are payable because the insured is still alive. The executor might surrender the policy to convert the policy into cash instead of distributing the policy to an estate beneficiary. This would give the estate beneficiary an immediate source of cash instead of having to wait until the death of the insured. On surrender, the proceeds of a life insurance policy would be taxable to the extent the proceeds exceeded the estate's basis. The estate's basis would equal the premiums paid by the deceased as well as those paid by the executor before surrender.

Please contact us to discuss the tax aspects of insurance distributions or any other tax compliance or planning issue.

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