Volume 3, Issue 1

March 2008

# Tax Talk

*A quarterly publication of Bridges & Dunn-Rankin, LLP*

## Inside this issue:


| | |
|---|---|
| The Economic Stimulus Act of 2008 | 1 |
| Member in the Spotlight – Phillip R. Poovey | 2 |
| Late 2007 Tax Legislation | 2 |
| Doing Business Abroad – A Review of the General Tax Rules | 2 |
| Client in the Spotlight – The Network, Inc. | 3 |
| IRS Issues Safe Harbor for Minimal Personal Use of Like-Kind Exchange Property | 4 |
| A 0% Rate on Long-Term Capital Gains and Dividends? | 4 |
| Trivia | 4 |


Dear Clients and Friends,

The traditional "busy season" is well under way at Bridges & Dunn-Rankin, as we begin to focus on getting financial statements and tax returns completed, along with keeping busy with our on-going consulting and transactional work and representation of clients in matters with the taxing authorities.

We have also been busy recently on the personnel front, making several nice additions to our firm. Phil Poovey, who I first got to know 21 years ago when we were both at KPMG, has recently joined the firm as a partner to bolster the resources and expertise of our Accounting and Attestation practice. Brock Bullard, who joined the firm 8 years ago following a stint at Ernst & Young, has been promoted to partner. Kyle Bartleson, who has worked for the firm in the past both as an employee and on a subcontract basis, has rejoined the firm. And Scott Fincher, who has seven years of experience in the accounting department of a real estate developer/home builder, will be joining the firm in June upon completion of his Masters in Accounting with Emphasis in Tax.

Congress has also been busy recently, having enacted several pieces of significant tax legislation during the latter part of 2007 and early 2008.

Kent Bridges, Managing Partner

In this issue we will review highlights of the recent tax legislation, provide an overview of the general tax rules associated with doing business abroad, discuss a recent IRS ruling with respect to vacation homes qualifying as like-kind exchange property, describe how you might enjoy a zero tax rate on long-term capital gains and dividends, and, as always, highlight a member of our firm and one of our clients.

We hope that you will enjoy this issue and gain from it some useful information.

Sincerely,

*Kent Bridges*

## The Economic Stimulus Act of 2008

On February 13, 2008, President Bush signed into law the *The Economic Stimulus Act of 2008* (the "Act"). Highlights of the Act include:

*Rebate checks* – Eligible individuals will receive tax rebate checks of up to $600 ($1,200 for a married couple filing jointly), plus an additional $300 per child. The amount of the rebate (excluding the $300 per child amount) is computed as the greater of: (a) the amount of income tax paid in 2007 (not to exceed $600 for an individual or $1,200 for a married couple filing jointly); or (b) $300 for an individual or $600 for a couple if their 2007 tax liability was less than these amounts but they had income of at least $3,000 from self-employment, veterans' disability payments, and social security benefits or they had a tax liability of at least $1 and gross income in excess of their basic standard deduction amount plus exemption (which likely means at least $8,950 of income for singles and $17,900 for married couples). Unfortunately, the amount of the rebate is phased out at a rate of 5 cents for each dollar of 2007 income above $75,000 for a single filer or $150,000 for a couple filing jointly. It will likely be May before the IRS can begin to process the rebate checks.

*Increased section 179 expense amount* – Under current law, most small businesses can elect to immediately expense up to $128,000 each year of the cost of furniture and equipment purchased for use in the business. This amount is phased out if the amount of furniture and equipment purchased during the year exceeds $510,000. The Economic Stimulus Act increases the amount that can be expensed in 2008 to $250,000, and increases the phase-out threshold to $800,000 of purchases.

*Bonus first-year depreciation* – For most new depreciable assets (other than buildings) placed in service during 2008 The Economic Stimulus Act will permit 50% of the cost to be expensed immediately, with the balance recovered under the regular depreciation rules. This special first-year deduction

*(Continued on page 2)*

Phillip R. Poovey, CPA

## Member in the Spotlight — Phil Poovey

Phil Poovey recently joined Bridges & Dunn-Rankin to increase the firm's resources and expertise in the Accounting and Assurance Services area. Phil, who holds a Bachelor of Accountancy with Distinction from George Washington University, started his accounting career in the audit department of KPMG in 1984. He left KPMG as an audit manager to join one of his clients, Ferro Union Southeast, as Controller and later Chief Financial Officer. His experience prior to joining Bridges & Dunn-Rankin also includes 3 years at the CPA firm Tarpley & Underwood and 1 year operating his own CPA firm.

Phil, a native of the Atlanta area, and his wife Lauren (also a CPA) enjoy hiking and spending time outdoors with their daughters, Kendall and Rachel.

Bridges & Dunn-Rankin is proud to have Phil Poovey as a member of our firm.

## The Economic Stimulus Act of 2008— continued

*(Continued from page 1)*

applies both for regular tax and alternative minimum tax. For autos and light trucks, for which first-year depreciation would otherwise be limited under the so-called "luxury automobile rules", bonus depreciation of $8,000 may be taken (bringing the total deduction to approximately $11,000). Property acquired under a binding contract entered into prior to 2008 will not qualify. On the other hand, property acquired during 2009 under a binding contract entered into during 2008 will qualify.

## Late 2007 Tax Legislation

In late 2007, several acts were passed which contained tax provisions, including *The Tax Increase Prevention Act of 2007* and *The Mortgage Forgiveness Debt Relief Act of 2007*. Highlights of the legislation include:

*Alternative minimum tax relief* – The alternative minimum tax ("AMT") is a separate but parallel system to the regular income tax. You must compute your tax under both systems, and pay the greater of the two. If the AMT is higher than the regular tax then this excess shows up on your return as an additional tax. For 2006, married individuals filing jointly were permitted a maximum exemption in computing the AMT of $62,550 and singles were permitted a maximum exemption of $42,500. For 2007, these maximum exemption amounts (which are subject to phase-out for higher income taxpayers), were scheduled to be reduced to $45,000 and $33,750, respectively. This would have meant millions more taxpayers being subject to the AMT for 2007. To avoid this, Congress has increased the exemptions for 2007 to $66,250 and $44,350, respectively. This represents a tax savings of up to $5,950 for those directly affected.

*Relief from tax on mortgage debt forgiveness* – In general, a discharge of indebtedness results in taxable income for the debtor, unless an exception is met. Prior to the recent legislation, there was no exception for a discharge of personal mortgage debt, unless the debtor was in bankruptcy or insolvent. The recent legislation provides that taxable income will not include any discharge (in whole or part) of qualified residence indebtedness during 2007 – 2009. The relief applies only to the original purchase price plus improvements of the taxpayer's principal residence. It does not apply to discharges of second mortgages or home equity loans unless the proceeds were used to acquire, construct or substantially improve the residence, or to refinance debt used for that purpose. The relief does not apply to second homes, vacation homes or investment properties, and the amount of relief is limited to $2,000,000.

*Deduction for mortgage insurance extended* – The deduction for mortgage insurance premiums, which was scheduled to expire at the end of 2007, has been extended for three more years.

*Increase in penalty for late filing of partnership and S-corp returns* - Historically, the penalty for late filing of a partnership or LLC return has been $50 per month per partner, up to a maximum of 5 months (i.e. $250 per partner). For a large partnership, this can be a significant penalty. The recent legislation makes it even worse. Under the new law, the penalty will be $85 per partner per month for a maximum of 12 months (i.e. up to $1,020 per partner). Also, the penalty will now apply to S-corps as well, whereas in the past there has generally been no penalty for late filing of an S-corp return unless it had tax due (which is unusual) or the IRS determined the failure to file was willful.

## Doing Business Abroad – A Review of the General Tax Rules

We are often asked by our U.S.-based clients who are considering conducting business outside the U.S. to advise them with respect to the tax consequences of such. The U.S. rules in this area are highly complex, and you also have to look to the tax rules of the country within which you are considering conducting business as well as to any tax treaty between the U.S. and such other country. With that caveat, a general overview is as follows.

*Worldwide tax system* – The U.S. taxes its citizens and residents (including domestic corporations) on their worldwide income, from whatever source derived. The U.S. generally permits a credit (the "foreign tax credit") against U.S. tax for taxes properly paid to other countries on income sourced to such other countries, so long as the effective rate paid to the other country does not exceed the effective rate paid to the U.S. on that same

*(Continued on page 3)*

## Doing Business Abroad – A Review of the General Tax Rules— continued

*(Continued from page 2)*

income. Any excess foreign tax paid becomes a carryforward to future years (unless carried back one year).

*Other countries' tax systems* – The tax systems of other countries vary, but most countries have a tax on income similar to the U.S. income tax. To the extent that a U.S. company, citizen or resident conducts business in another country, such foreign country will generally subject the income to its income tax, unless an exception is met or you are protected from that country's income tax under the treaty between the U.S. and the foreign country.

*Tax treaties* – In order to reduce the risk of duplicate taxation and to encourage international commerce, the U.S. has an income tax treaty with most major countries. A typical treaty provision provides that a U.S. resident or company is not subject to the other country's income tax on income from business conducted in the foreign country, so long as the U.S. resident or company does not have a "permanent establishment" (which generally means a fixed place of business) in the foreign country. In the case of an individual, the U.S. resident is generally not subject to tax in the foreign country so long as he or she is not present in the country for more than 183 days during the year (unless on the payroll of a foreign company, in which case the salary is typically subject to tax in the foreign country if over a fairly small amount). Other typical treaty provisions provide for a reduced or zero rate of withholding on interest, dividends, rents, royalties and other types of passive income paid by a resident of one country to a resident of the other.

*Totalization agreements* – The U.S. has agreements with many countries whereby U.S. employees going abroad pay social security tax only to the U.S. government or, if they instead pay social security tax to the foreign government, they get credit within the U.S. social security system for the social security tax paid to a foreign government.

*Foreign earned income exclusion* – A U.S. citizen working abroad may be able to exclude up to $87,600 of his foreign earned income plus up to $12,264 of housing costs from U.S. tax if certain requirements are met. In order to be eligible for this exclusion you must either be a resident of a foreign country for an uninterrupted period which includes an entire tax year or remain outside the U.S. for at least 330 full days during a period of 12 consecutive months. To the extent that the foreign country has an income tax rate as high or higher than that of the U.S., little benefit is likely to be gained from this provision (since the foreign taxes paid would likely be creditable against the U.S. tax otherwise due). However, if you are working in a foreign country with little or no income tax, this provision can be very beneficial.

*Controlled foreign corporations* – While a U.S. company is subject to U.S. tax on its worldwide income, the income of a foreign subsidiary of a U.S. company is not necessarily subject to U.S. tax, provided the income is from the active conduct of a business in the foreign country. Passive type income (e.g. interest, dividends, and rents) typically will be subject to current U.S. tax even if in a foreign subsidiary, as will earnings of the foreign subsidiary invested in U.S. property or any earnings actually distributed back to the U.S. parent company or shareholders. In some cases, it is advantageous to structure your foreign operations through an entity that will be recognized as a corporation in the foreign jurisdiction, but treated as a flow-through entity for U.S. tax purposes. This can be advantageous if losses are anticipated from the foreign business which you wish to deduct against U.S. income, or as a way of minimizing duplicate taxation (especially if the U.S. parent company is a flow-through entity). In other cases, especially if the business will be subject to little or no tax in the foreign jurisdiction and has a need to accumulate capital, it can be more advantageous to structure the business through a foreign entity that will be treated as a C-corporation for U.S. tax purposes. To the extent that a foreign corporation is controlled by U.S. persons, there are annual reporting requirements with the IRS to enable the IRS to monitor the ownership and financial activities of the foreign corporation and any transactions it has with its U.S. owner(s).

*Transfer pricing* - In order to prevent arbitrary shifting of income between U.S. companies and their foreign affiliates, tax rules require arms-length transaction pricing for purchases of goods and services between related companies.

## Client in the Spotlight — The Network, Inc.

The Network is a technology-based company that for 25 years has helped clients collect information and address critical issues such as ethics, risk management and service quality.

In 1983, Ralph Childs, a former FBI special agent, founded the company by introducing the first 24x7 anonymous reporting system which enabled employees to bring unethical, illegal, or irresponsible activities to their employers' attention without fear of reprisal. Over the years the company grew steadily and expanded its service offerings to include employee communications programs to address workplace issues like theft, sexual harassment and safety.

Today, under the leadership of current owners/executives Tony Malone and Julio Cantillo, The Network uses award-winning proprietary software and a state-of-the-art call center to deliver services like ethics and compliance hotlines, insurance claim reporting and employee communications to 2,500 clients, including nearly half of the Fortune 500.

Bridges & Dunn-Rankin is proud to be associated with The Network, Inc.

## IRS Issues Safe Harbor for Minimal Personal Use of Like-Kind Exchange Property

Internal Revenue Code section 1031 contains very favorable rules whereby you can exchange an appreciated property for a property of "like-kind" and avoid triggering any tax gain in the process. In order to qualify for this favorable treatment both the property given up and the property received must be "used in a trade or business or held for investment".

We are often asked whether a vacation home can qualify. If you use the vacation home solely for personal purposes as a second residence, then the answer is likely no. However, what if you use it some personally and also rent it out some? The IRS has recently issued a safe harbor whereby it will not challenge whether a property qualifies, so long as the property is owned by the taxpayer for at least 24 months, and during each of the two 12-month periods (the 24 months immediately before the exchange in the case of the relinquished property and the 24 months immediately after the exchange in the case of the replacement property) the taxpayer rents the property to others (at fair market rents) for at least 14 days and does not use the property personally more than the greater of 14 days or 10 percent of the number of days rented to others.

This ruling is a "safe harbor", meaning that if you come within its provisions the IRS will not challenge you, but it does not mean that you automatically fail to qualify for like-kind exchange treatment if you fall outside the safe harbor guidelines. However, it is reasonable to expect that IRS agents will likely use this as a guideline in examinations, so it is best to stay within these guidelines where possible.

## A 0% Rate on Long-Term Capital Gains and Dividends?

Under current law, the Federal tax rate for individuals on long-term capital gains (LTCG) and qualified dividends is 15%. That's pretty good, considering that the Federal rate on other types of income goes up to 35%. But what about a 0% rate?

Beginning in 2008, a zero tax rate applies to any LTCG and qualified dividends which would otherwise be subject to tax at the ordinary rate brackets below 25% (e.g. up to $65,100 of taxable income for married couples filing jointly). Accordingly, a couple with net taxable income of less than $65,100 will pay zero Federal tax on their LTCG and qualified dividends. Higher income taxpayers can also enjoy this zero rate on a portion of their income, so long as their itemized deductions are sufficient to offset their other items of ordinary income. For example, an investor (filing a joint return) with $1,000,000 of long-term capital gain, $100,000 of interest income, and $100,000 of itemized deductions would not pay any Federal tax on $65,100 of his capital gain income.


Bridges & Dunn-Rankin, LLP
CERTIFIED PUBLIC ACCOUNTANTS

200 Galleria Parkway
Suite 1950
Atlanta, GA 30339

Phone: 770-563-8888
Fax: 770-563-8885
www.bridgesdunnrankin.com


Bridges & Dunn-Rankin, LLP is an Atlanta-based full-service accounting firm serving clients in the technology, real estate, services, manufacturing, distribution, construction and healthcare industries, as well as high net worth individuals.



### Trivia

Last quarter's trivia question was "What is the name of the private equity firm whose announced IPO (and related disclosure that its top officers had earned hundreds of millions in compensation in 2006 and were expected to receive billions from the partnership's IPO) gave momentum to proposed legislation to tax "carried interests" as ordinary income rather than long-term capital gain?" The first person to respond with the correct answer of "The Blackstone Group" was Frank Butterfield of Homrich and Berg.

Now for this quarter's contest. An article in this issue provides an overview of the basic tax rules of doing business abroad. Prior to 2000, U.S. tax law designed to encourage and reward exporters provided for a special type of entity which enabled U.S. companies to avoid U.S. tax on a portion of their income from exporting. These rules were repealed in 2000 after the World Trade Organization found them to be an illegal export subsidy. What was the name of this type of entity?

The first person to provide the correct answer will receive 4 tickets to a Braves game of their choice next season. E-mail your answer to brittany.lovvorn@bridgesdunnrankin.com.