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Client Information Bulletin

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How Long to Keep Tax Records

IRS often focuses on four audit areas

Keeping accurate records is the best way you can protect yourself in the event of an IRS audit. But how long do you have to hold onto your records? There is no definitive answer.

At the very least, you should keep your records until the statute of limitations for the return expires. Normally, this is three years after the due date (including extensions) or two years after the tax is paid—whichever is later. But the limit is six years if your gross income is understated by more than 25% of the amount shown on your return. Furthermore, there is no time limit at all if an income tax return is found to be false or fraudulent.

Therefore, conservatively speaking, you might hold onto tax records for as long as, say, ten years. Consult with your tax return professional.

What sort of tax records are we referring to? The obvious ones are your 1040s, W-2s, 1099s, K-1s and receipts of business expenditures. However, there are other records that may be overlooked or discarded prematurely, especially in the following four areas:

1. Charitable donations: Under new rules that went in effect in 2007, you must have a bank record or written communication from a charity for any monetary contribution. Furthermore, you are required to obtain a

written acknowledgment for any single contribution of \$250 or more. Other special rules apply for donations of property valued over \$500. For donations valued above \$5,000, you must obtain an appraisal of the property.

Note that the cost of the appraisal itself is deductible as a miscellaneous expense. Your unreimbursed miscellaneous expenses are deductible to the extent the total for the year exceeds 2% of your AGI.

2. Investments: You should be able to document your gain or loss from the sale of all securities. In particular, it may be difficult to keep track of mutual fund sales. Be sure to supply your tax return preparer with all the relevant information. Because several methods may be used to calculate mutual fund gains and losses, this can make a big dollars-and-cents difference on your tax return.

3. Home sales: It is important to substantiate certain deductions (e.g., prorated mortgage interest and real estate tax paid up to the date of the sale may be deducted) to determine the “net” amount realized from the sale of a home. Similarly, detailed records of home improvement costs may help reduce your taxable gain when you sell the home.

4. Travel and entertainment expenses: Traditionally, the IRS pays extra-close attention to travel and

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entertainment expenses deducted by individuals. **One reason:** There are strict substantiation rules imposed by the IRS in this area.

As a general rule, you must document the date, amount of the expense, the business purpose and various other

details (depending on the nature of the expense). Note that receipts are required for items of \$75 or more.

It is worthwhile to repeat this: *The best protection you can have in the event of an audit is to keep accurate and detailed records in an organized manner.*

Swapping Properties in a Down Market

Using a qualified intermediary for the deal

Are you finding it difficult to sell investment property in this real estate market? One possible alternative is to arrange an exchange of properties with another owner.

Tax payoff: If the properties qualify as “like-kind” properties, you do not have to pay current tax on the exchange. This refers to the nature, character or class of the property—not its grade or quality. For example, you might swap an office building for an apartment building of the same value. As a result, neither party may be liable for tax (but see below).



At this point, a qualified intermediary uses the sales proceeds to purchase the replacement property from another owner, Derek. Finally, the intermediary transfers this property to Alice to complete the like-kind exchange.

For tax purposes, Alice is considered to have swapped properties tax-free with the intermediary. This is permitted because she never actually sees the cash from the sale of the relinquished property nor is any additional cash paid to acquire the replacement property.

However, trading real estate properties is usually not so simple. Typically, you might have your eye on a particular building, but the owner is not interested in any of the properties you own. In that case, the exchange may involve multiple parties.

The IRS has approved the use of a qualified intermediary to facilitate the deal, as long as the intermediary is not connected with one of the parties.

Example: Say that Alice sells property that will be relinquished to Barry. Barry pays an intermediary, Cheryl, instead of Alice. The intermediary holds the sales proceeds on Alice’s behalf until a suitable replacement property is identified.

Of course, qualified intermediaries charge for their services, so this cost must be figured into the transaction. More details are available upon request.

Be aware that there are two time restrictions involved in a multiple-party swap. The property you are receiving must be identified within 45 days of the original transfer, and you must take title to the property within 180 days (or your tax return due date plus any extensions, if that is sooner).

Caution: If you receive any money or property as part of the deal, the additional amount (referred to as “boot” by tax practitioners) is subject to tax. However, no loss is recognized by the taxpayer who provides the boot. Note that the assumption of a greater mortgage is also treated as boot for this purpose.

The amount of taxable boot is equal to the lesser of the realized gain (i.e., the difference between the tax basis of the property you are relinquishing and the fair-market value of what you have received in exchange, including any boot) or the fair-market value of the boot.

This is a complex area of the tax law. Be sure to consult with a professional tax adviser before you sign any contracts.



Give Us A Call!

Do you have any questions or comments about **Client Information Bulletin** or your individual situation? Please do not hesitate to contact our office.

We would be glad to serve you in any way we can.

Key Changes for Family and Medical Leaves

New regulations modify existing rules

If you have owned a business at some point in the last two decades, you have probably heard plenty about the Family and Medical Leave Act of 1993 (FMLA). But you may not be aware of recent regulatory changes to this important federal legislation affecting both employers and employees. The new rules are effective as of January 16, 2009.

Background: Under the FMLA, an employee is allowed to take up to 12 weeks of unpaid leave from his or her job for the birth or adoption of a child, for reasons relating to a personal medical condition or to care for another family member. The employee can keep benefits during the leave period, but he or she must continue to pay the required employee portion for those benefits. In addition, the employee has the right to return to the same or equivalent position, pay and benefits at the end of the leave.

The new regulations include several significant changes and clarifications of these rules. The following is a brief summary of the key points.

Military personnel: An employee with a family member who is on active military duty can now take up to 26 weeks of unpaid FMLA leave in each 12-month period to care for the military family member. The new regulations also define qualifying events that count as "military

duty." Similarly, families of National Guard and Reserve members are allowed to take up to 12 weeks of job-protected leave per year to manage their affairs.

Serious conditions:

The new regulations refine the definition of a "serious health condition" for FMLA purposes. It now requires two visits to a health care provider within 30 days of the period of incapacity (the first visit must occur within seven days of incapacity). Visits must be made in person.

Direct contacts: An employer may directly contact the employee's physician or other health care provider regarding health details on the employee's FMLA certification form. **Note:** The employee's "direct supervisor" is prohibited from making such inquiries. Also, the employer cannot request information beyond what is required by the certification form.

Employer notice obligations: Besides posting a notice about FMLA procedures in a prominent place at work (e.g., company bulletin board), an employer must provide the same notice in its employee manual or distribute a copy of the FMLA policy to its new hires. Employers now have five business days (increased from just two days) to send out FMLA eligibility and designation notices to employees.

Employee notice obligations: Prior to the new regulations, an employee could give notice of the need for an FMLA leave for up to two business days after being out on the leave, even if he or she could have provided notice earlier. But the new rules require employees to follow the employer's general call-in procedures unless unusual circumstances exist.

Note that the individual states may also impose rules relating to employee family and medical leaves. For example, a new law in New Jersey taking effect on July 1, 2009, entitles most employees in the state to take up to six weeks of paid family leave.

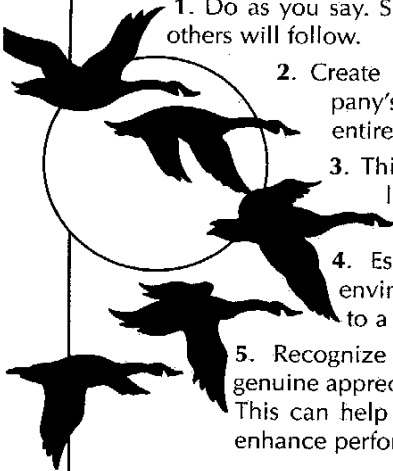
It may be necessary to obtain additional guidance concerning application of these new rules. Consult with a professional adviser.



Five Ways to Lead the Flock

How does a business manager become a successful leader? There is no exact blueprint, but here are five suggestions to build upon.

1. Do as you say. Set a positive example that others will follow.
2. Create a vision. Make the company's objectives clear to the entire workforce.
3. Think outside the box. Keep looking for new ways to improve the operation.
4. Establish trust. Provide an environment that is conducive to a team concept.
5. Recognize accomplishments. Show genuine appreciation for work well done. This can help boost morale and further enhance performance.



Estate Planning: Make It Your Business

Sound advice for busy business owners

When you own a small business, it seems as if every day is a whirlwind. No one could blame you for being overwhelmed—especially in this current economic environment. However, when it is possible, try to spare some time for estate planning.

This critical function is often overlooked by busy entrepreneurs. But a comprehensive estate plan may avoid a sale of a business interest at distress prices while managing to preserve assets for your loved ones.

Where do you begin? Start by considering the benefits you want to derive from your assets, the risks you are willing to take, and how much you will need for retirement or other purposes. Once you spell out your goals, you can formulate the best way to achieve them.

Next, provide your advisers with an inventory of assets. You can do this by simply listing all the assets you own in addition to your business interest (e.g., real estate, stocks, bonds, bank accounts, life insurance, etc.). With professional guidance, you can project the future net worth of these assets.

Furthermore, seek to minimize potential estate taxes. Note that transfers between spouses are completely ex-



empt from federal estate tax. Currently, the federal estate-tax exemption can shelter other transfers of up to \$3.5 million for 2009 (up from \$2 million for 2008); the estate tax is eliminated for 2010. However, the federal estate tax will be revived in 2011, unless new legislation is enacted. No one is quite sure how this will eventually unfold.

You might also reduce your estate through lifetime gifts. For 2009, the annual gift-tax exemption covers gifts of up to \$13,000 per recipient (up from \$12,000 for 2008). In addition, special estate-tax breaks for business interests may be available. For instance, the federal estate tax due on a large business interest may be spread out over a 14-year period if certain conditions are met.

Finally, consider life insurance as part of your estate plan. In particular, business owners may rely on life insurance for its liquidity. If the policy is structured carefully, the proceeds can be received free of both estate and income taxes.

Of course, this is only a general overview that may not take your personal circumstances into account. It is important to have a plan designed to fit your specific needs.

Facts and Figures

Timely points of particular interest

➤ **Tax Judgment**—If you prevail in a job discrimination lawsuit, you are generally taxed on the court award. **New case:** An ex-employee was pushed into a higher tax bracket after being awarded \$200,000 in back pay and damages. To offset the increased tax liability, the Third Circuit Court added almost \$7,000 in compensation. This effectively covers the income tax due because wages had not been paid over a period of time.

➤ **Office Space**—How can you stir up creativity among workers? One idea is to have two employees switch desks for a week. The theory is that a change in scenery may stimulate new ideas and a different “look” at the operation. It is easy to become bogged down in the same routine when you work out of the same office all the time. If this technique is successful, try it on a regular basis.

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