CURRENT INTEREST

MARTIN WERBELOW LLP

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2008 Housing Act —

Major Provisions Include Tax Incentives

by Noriko Nakanishi
Partner

The recently enacted 2008 Housing and Economic Recovery Act includes credits, deductions and revenue raisers. Details on the major provisions of this $15.1 billion worth of housing tax incentives follow.

Credit for first-time home buyers

The single largest provision is a measure that allows individuals who are buying their first homes to take a tax credit of up to $7,500 of the purchase price. Designed to help reduce the existing stock of unoccupied housing, the tax credit allows qualified home buyers to subtract the credit amount from their federal income taxes when they buy a home.

However, they are then required to pay the credit back over 15 years. The result is that the credit resembles an interest-free loan that must be repaid to the government.

Property tax deduction for non-itemizers

The 2008 Housing Act creates a new, temporary property tax deduction for those taxpayers who claim the standard deduction rather than itemizing their deductions. A brief overview of this new provision follows.

- The provision creates a new standard deduction for state and local real property taxes paid by non-itemizers. Since most homeowners who are paying on a mortgage have enough deductions, such as mortgage interest and property taxes, to justify itemizing them on their returns, this new provision chiefly benefits homeowners who have paid off their homes.
- The deduction is available only for one year: for tax years beginning in 2008.
- The amount of deduction is as much as $500 for single filers and $1,000 for joint filers. Since this is a deduction and not a credit (that is, a dollar-for-dollar reduction in tax liability), the actual tax benefit will not be substantial.

Home sale exclusion rules tightened

Most homeowners are aware of the home sale exclusion, a provision of the tax laws which provides that homeowners who sell their principal residence typically don't need to pay taxes on as much as $500,000 of their gain if they meet certain conditions. The $500,000 exemption is the maximum exclusion for a married couple filing jointly; taxpayers filing individually get an exemption of up to $250,000.

To be eligible for the full exclusion, a taxpayer must have owned the home — and lived in it as his or her principal residence — for at least two of the five years prior to the sale. Because of the principal residence requirement, vacation or second homes normally do not qualify for the exclusion.

However, in what some saw as a loophole, the law permitted taxpayers to convert their second home to their principal residence, live in it for two years, sell it and take the full $250,000/$500,000 exclusion available for principal residences even though portions of their gains were attributa-

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FDIC Insurance, Trust Accounts

Review coverage for your accounts

(See page 3 for details)

State Use Tax —

Tax Due on Internet, Out-of-State Purchases

by Priscilla Bintoro
Senior Accountant

If you purchase merchandise from a vendor located outside the country or the state of California, you may owe California use tax. This includes purchases you make over the Internet.

Use tax is paid directly to the state in lieu of sales tax that is paid directly to the retailer. The rule of thumb is: You owe use tax if what you bought would have been subject to sales tax had you purchased it at a local store and you did not pay California sales tax.

You generally owe California use tax when you use, store or consume — in California — tangible personal property purchased from an out-of-state vendor. If the vendor does not collect the California tax on the purchase, the purchaser must pay the tax directly to the state.

If you do not report and pay your use tax in a timely manner, such as with your income tax return, the state will assess penalties and interest.

What is and is not subject to sales and use tax can be complicated. There are numerous exceptions to the rules, but some of the common ways in which people make out-of-state purchases that are subject to use tax follow.

• Internet purchases
• Shopping channel purchases
• Certain foreign purchases
• Mail-order purchases

Examples of some common items subject to use tax follow.

• Clothing, toys, jewelry, make-up
• Computers, cameras and other electronic equipment
• Over-the-counter medications
• Collectibles
• CDs and books
• Household items, such as small appliances
• Sports equipment
• Computer programs shipped on a disc

Purchases that are exempt from sales tax are also exempt from use tax. A few examples follow.

• Music and other online media purchases for your iPod or MP3 player and transferred directly over the Internet
• Newspapers, magazines and other periodicals
• The first $800 in property hand-carried when returning from a foreign country ($400 prior to 2008)
• Software that is transferred over the Internet if nothing is mailed to you
• Prescription drugs
• Most food items
• Purchases for which the seller added California sales tax

What if another state sales tax was paid?

If you were required to pay, and did pay, another state's sales tax on the purchase, you may take a credit against the California use tax due. So, for example, if you paid 7 percent sales tax to another state, you are required to pay only the difference between the 7 percent and the sales tax rate in your area.

Why use tax and why now?

The use tax is intended to protect California merchants who otherwise would be at a competitive disadvantage when out-of-state vendors make sales to California customers without charging sales tax.

With the advent of Internet purchases and an increase in the number of people buying from mail-order businesses, California has experienced a loss of sales tax revenue. Use tax is not new, but most people were not aware that it existed.

So the cash-strapped state has created a campaign to educate people and is channeling resources to actively pursue people who don't pay use tax.

You may owe California use tax

How do you pay the use tax?

If you do not have a California resale permit, you may either pay the use tax via your California income tax return or file Form BOE-401-DS, Individual Use Tax Return.

The form is straight forward, easy to complete and available on the Web site www.boe.ca.gov.

Or, if you prefer, you can disclose to us your qualifying purchases, and we can add the use tax to your California income tax liability.

FDIC Insurance And Trust Accounts —

Do Your Expectations Match Reality?

by David P. Beringer
Partner

Our offices sit kitty-corner from the main IndyMac offices and branch in Pasadena. The customer lines streaming around the building, the news vans darting about and the incoming calls from anxious clients all served to make us pay close attention to the FDIC deposit insurance guidelines.

Most of us are aware of the basic rules and limits on single accounts, retirement accounts and business entity accounts. Misinformation and confusion still surround the FDIC rules as they pertain to informal trusts, formal revocable trusts and irrevocable trusts.

Action item: We strongly urge you to review the coverage available for your trust accounts. Contact the FDIC Web site (www.fdic.gov/deposit/deposits) and download the PDF of "Your Insured Deposits" booklet or contact the FDIC at 877/275-3342 for a copy. Or you may contact Carol McElwain at our firm 626/577-1440, and she will gladly forward the printed material to you.

The FDIC makes distinctions between the three different trust vehicles described previously. Its booklet will explain the information that follows in detail:

- What the bank needs to have on file
- What it considers to be the proper titling of the trust account
- What it requires for the proper execution of the bank signature card
- What constitutes a qualifying beneficiary
- What constitutes the kinship requirement
- What the impact is of equal and unequal beneficiary interests

Many will learn that they have more deposits at risk or, perhaps, even more FDIC coverage than they thought they had.

Please understand the deposit insurance guidelines and take the necessary action steps to obtain full coverage.

2008 Housing Act – *from page 1*

ble to periods during which the property was used as a vacation or second home, not a principal residence.

The new law closes that loophole by requiring homeowners to pay taxes on gains made from the sale of a second home to reflect the portion of time the home was not used as a principal residence. For example, it may have been used as a vacation or rental property.

The amount taxed will be based on the portion of the time during which the taxpayer owned the home that the house was used as a vacation home or rented out.

The rest of the gain remains eligible for the up-to-$500,000 exclusion, as long as the two-out-of-five-year usage and ownership tests are met.

The new law effectively reduces the exclusion, based on the ratio of years of use as a principal residence to the total time of ownership. For example, if a taxpayer owned a vacation home for 10 years but lived in it as a principal residence for only the final two years prior to sale, the maximum available exclusion would be reduced by four-fifths. Accordingly, a $400,000 gain on the sale that would have been eligible for the full exclusion prior to this new law now would be reduced by four-fifths to $80,000.

Good news for current owners of second homes is that the new law is not retroactive. The new restriction applies only to sales after 2008. Plus, any periods of personal or rental use before 2009 are ignored for purposes of the provision.

Also, the new law doesn't change the rule that allows homeowners to take advantage of the home sale exclusion every two years. Taxpayers can still "home hop" with full tax exclusion if they own only one home at a time.

Moreover, the taxpayer still qualifies for capital gain treatment on the amount of gain that cannot be excluded.

We hope this information is helpful. If you would like more details about these provisions or any other aspect of the new law, please do not hesitate to call us at 626/577-1440.

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More than 48.7 percent of all statistics are useless.

—— Inside This Issue ——

Tips Most Effective —

Fraud Report Published

by Eric Chan
Staff Accountant

The Association of Certified Fraud Examiners (ACFE) recently published the results of its annual survey. Occupational fraud (personal enrichment through one's occupation) is much more likely to be detected by a tip than by audit or other controls.

The ACFE reports the following:

• Frauds were committed most often by the accounting department or upper management, and most perpetrators were first-time offenders.

• Fraud schemes frequently continue for years before they are detected. The typical time frame is around two years.

• Small businesses are especially vulnerable to fraud.

• Despite increased focus on anti-fraud controls in the wake of Sarbanes-Oxley and mandated consideration of public accounting standards, tips from those observing the fraud were the most effective means of fraud detection.

The 2008 report is available on the ACFE Web site: www.acfe.com/resources/publications. The report provides helpful anti-fraud information and ideas.

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