



ARKANSAS SOCIETY OF • ACCOUNTANTS

RESPECTED ACCOUNTING PROFESSIONALS SERVING OUR COMMUNITIES

Monthly Newsletter

October 2008

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• FROM YOUR PRESIDENT'S PEN •

Dear Members

David Costello, President of NASBA recently told a story of an avid duck hunter who was looking for a new bird dog. His search came to an end when he found a dog, which could walk on water to retrieve a bird. The hunter was so excited about this, but he wondered how he would break this news to his friends, because he knew they wouldn't believe him.

So the hunter invited one of his buddies to go hunting with him. They made their way to the duck blind and waited. When a flock of ducks flew by, they raised their guns and shot. And sure enough, the dog responded by running on top of the water and retrieving the bird. However, the friend didn't say a word about the dog.

When they got in the truck and started heading

home, the first hunter couldn't resist in asking, "Did you notice anything different about my dog?" His friend responded, "Yeah, he can't swim!"

I think too many times in our lives we are just like the hunter's friend in this story. We can't seem to realize the change around us because we've let ourselves become entrenched in the same old rut.

I appreciate this opportunity to serve the ASA in the next year as your president. I truly believe this society offers us chances to see some of the "water -walking dogs" for our practices. As I tried to explain to my 10-year old son last night as he complained about school that we can't ever stop learning. Hopefully over the next year we can continue to challenge each other to keep learning and growing. The public we serve demands we be on top of our game.

Tom Ed Simmons
President

FORM 982 – CANCELLATION OF DEBT EXCLUSION

By Bob Jennings
Jennings Seminars

Introduction

The cancellation of debt by a creditor creates taxable income for the debtor which is reported on form 1040, line 21 as other income. The Internal Revenue Code has 6 exceptions to this rule. Additional activities similar to cancellation of debt include short sales, discounts for early principal repayment, foreclosures, debt forgiveness and other similar activities. If the cancellation is intended as a gift the cancellation does not represent taxable income, although the lender may be required to file a gift tax return. Interest included in canceled debt is usually also taxable if forgiven.

To utilize one of the exceptions below the taxpayer number file Form 982 with the return for the year of the exclusion. Attach a statement for form 982 describing the transactions that resulted in the loss of basis and identifying the property whose basis was reduced.

Exception 1: The student loan exception.

Some student loans which are accepted by certain conditions that the student will work in certain professions for a certain period of time are exempt if made by qualified agencies. Only student loans from governmental agencies and certain educational institutions and charities qualify.

Exception 2: The bankruptcy exception.

If the debt is canceled in a bankruptcy case under Title 11 of the US Code (which includes Chapters 7, 11 and 13), the forgiven debt is excluded but only if the debtor is under jurisdiction of the court and the cancellation of the debt is granted by the court or occurs as a result of a plan approved by the court. If bankrupt, the taxpayer may not utilize the insolvency, qualified farm debt or qualified real property business indebtedness exclusions.

Exception 3: The insolvency exception.

Insolvency is defined as a situation where the taxpayer's total debt is greater than the FMV of the taxpayer's total assets. However only debt to the extent is insolvent is excludable. If the amount of debt discharged is more than the amount insolvent, the excess is taxable.

Example 1; Kyle recently graduated from college and got caught in the temptation of credit cards. His total credit card debt is \$40,000; he owes \$30,000 on his car and \$30,000 on student loans, for a total debt of \$100,000. His assets are the car with a FMV of \$25,000 and \$5,000 personal of personal property, for FMV of assets of \$30,000. He is therefore insolvent to the tune of \$70,000 (\$100,000 debt-FMV assets of \$30,000).

If the credit card companies discharge the entire \$40,000 he may exclude the full amount.

If the credit card and auto loan companies discharge all debts (\$70,000) he may exclude the full amount.

If the credit card, auto loan and student loan companies discharge all debts, he may exclude \$70,000 (the amount insolvent) but the remaining \$30,000 is taxable.

The FMV of all assets of the taxpayer, including personal residence, retirement accounts, etc., must be included in the FMV calculation for insolvency purposes. All recourse debt is included in the calculation.

Forgiveness of a non-recourse loan resulting from a foreclosure does not result in cancellation of debt income in most cases, although it is treated as a sale of a personal residence for the amount of the non-recourse debt. In California and some other states,, purchase money mortgages, which are mortgages where the borrowed funds are used to purchase the house, are generally treated as non-recourse debt (this includes 2nd mortgages obtained at the initial purchase in 90 – 100% financing situations). This means there will be no COD income on a foreclosure, but that there will be sale of personal residence income. However, if the California loan has been refinanced the loan is now considered a recourse loan because it is no longer a “purchase money” loan.

Action on foreclosure	Non-Recourse Debt	Recourse Debt
<u>Debt</u>		
Debt forgiveness	No	Yes. To Income?
<u>Extent of Debt</u>		
Home sale?	Yes, at Debt	Yes- at FMV
<u>Balance on foreclosure</u>		
COD Income	n/a	Total Debt
<u>Actual payoff made</u>		
Sale of home income	Debt Balance	Actual Payoff
Qualifying for exclusion	Basis	Made-Basis

Exception 4: The qualified farm debt exception. If the debt is qualified farm debt and is canceled by a qualified, unrelated person who is actively and regularly engaged in the business of lending money. The debt must have been incurred directly in the business of farming and 50% or more of total receipts in the past 3 years have been from farming.

Exception 5: The qualified real property business debt exception. Qualified real property business indebtedness is a debt incurred or assumed in connected with a piece of real property used in a trade or business and this is secured by that piece of real property. For debts incurred or assumed after 1992, the debt proceeds must be used to acquire, construct, reconstruct, or substantially improve the real property.

Exception 6: The qualified principal residence exclusion. In the Mortgage Forgiveness Debt Relief Act of 2007 signed into law on 12/20/2007 an additional exclusion was allowed for qualified debt forgiveness on a principal residence of up to \$2,000,000,000 (\$1 MM MFS) if the discharge is because of a decline in value of the residence.

The qualified amount is for acquisition indebtedness which is the amount paid to buy, build or improve a home. The relief applies to refinancing of qualifying debt to the extent that the refinancing did not exceed the amount of the original debt. Forgiveness of debt on vacation or other second homes will still count as income as do equity loans for personal purposes or investments do not qualify for the exclusion, nor do loans to

purchase second homes. The forgiveness of home-equity debt where the cash was used to pay off credit card debt, education, medical expenses, etc is fully taxable.

In our fall 1040 in depth seminars we will discuss debt forgiveness in detail, with examples on completing the forms, excluding forgiveness and tax issues for foreclosure, short sales, abandonments, deeds in lieu of foreclosure and much more.

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SILENT AUCTION RESULTS

A big thank you to everyone who participated in the silent auction this year. Whether you donated items, purchased items or helped carry boxes, it was all appreciated.

We raised \$907.00 through the auction. With

the carryover from last year, we will still be at our \$1,000.00 goal.

Let's start planning now to make next year's event a little bigger and better!

Thank you,
Donna Gowan & Marchelle Foshee
Silent Auction Committee

TAX BITES

The recently enacted Housing and Economic Recovery Act of 2008 contains these new tax benefits for home owners...

- First time home-buyer's tax credit. This is worth \$7,500 or 10% of the purchase price of a home, whichever is less. Rules...

1. The credit applies only to homes purchased after April 8, 2008, and before July 1, 2009, to be used as main residences.

2. You can't claim it if you owned a primary residence within the prior three years.

3. The credit, which reduces your tax bill dollar, must be repaid in equal installments over 15 years, so it really functions as an interest-free loan. If you sell house before the loan is repaid, its full remaining balance becomes due. But if you die, the balance is forgiven.

4. The credit is cut back as adjusted gross

income rises from \$150,000 to \$170,000 on a joint return and \$75,000 to \$95,000 on a single return.

- Property tax deduction for non-itemizers. The new law lets taxpayers who claim the standard deduction instead of itemizing deductions write off up to \$500 of property taxes on a single return or \$1,000 on a joint return. The write-off is an addition to the standard deduction.

Until not, property taxes have been deductible only among itemized deductions.

By: Ingrid John, CPA, director, Capital Management Group, LLC
Washington, D.C.

DON'T FORGET TO REGISTER EARLY FOR THE GEAR UP 1040 SEMINAR. LITTLE ROCK AND SPRINGDALE. IF YOU NEED A FORM VISIT OUR WEBSITE AND PRINT ONE.

www.arspa.org

NEW IRA RULES

Two rule changes will occur in 2010. One will make more people eligible to convert a traditional IRA (from which withdrawals are

taxable) to a Roth IRA (from which withdrawals are tax free). The other will reduce the tax cost of making such a conversion.

To make a conversion now, your adjusted gross income cannot exceed \$100,000 (on either a single or joint return). In 2010, this income limit eliminated.

Upon conversion, the value of the traditional IRA (not including any non-deductible contributions made to it) is taxable income. Under current law, this income can easily push an IRA owner into a higher marginal tax bracket, making a conversion an expensive proposition.

But for 2010 only, income from an IRA conversion can be reported equally on tax returns for two separate years - 2011 and 2012. (You report half the income in 2011 and the other half in 2012), to spread out your tax obligation). This delays part of your tax payment and may keep you from being pushed into a higher bracket.

PAY MORTGAGE EARLY?

In this troubled economy, should we make extra payments on our home mortgage early to get rid of the debt?

Probably not. You get the most financial benefit from prepaying your highest-interest-rate debt first, starting with credit cards. Assuming that your home mortgage carries a fixed rate, it is probably your lowest-rate debt, especially after

the tax deduction for the interest on it, so it would be the last one you should pay. (Possible exception: a 0% vehicle loan of the type often offered by carmakers.)

Even if your mortgage is your only debt, you probably shouldn't pay it down more quickly than you have to. *Two reasons:* First, if a later emergency need for funds arises, it may not be easy to get a new home-equity loan quickly and the rate may be higher than your current mortgage rate. Second, if you have to borrow from a source other than your home, not only will your interest rate be higher than it is on your mortgage loan, but you will lose the tax deduction you get for the mortgage interest.

Better: Take the funds that you would use to prepay your mortgage, and save them in a separate interest-bearing account. You will increase your wealth and maintain your liquidity.

HIDDEN TRAPS IN BUYING A HYBRID CAR

With gas hovering at about \$4 a gallon, vehicles with fuel-saving "hybrid" gas-electric power have become popular – especially since a federal tax credit up to \$3,400 is available for hybrids. But, there are traps in this credit – even with high gas prices, a hybrid may not save the money you would think.

In most cases, the size of the federal hybrid – vehicle tax credit is much less than \$3,400 because it varies with each vehicle's fuel efficiency. Also, you may not be able to claim the credit at all. Possible Problems...

The tax credit for the hybrid you want doesn't exist. The law limits the number of vehicles each hybrid car manufacturer sells that are eligible for the credit – and reduces the credit as that number is approached. For the most popular hybrids, the credit has already been eliminated.

The Toyota Prius (about 47 mpg combined city/highway driving) and other Toyota hybrids are no longer eligible for any credit.

The credit for the Honda Civic hybrid (about 42 mpg) and other Honda hybrids has been reduced by 75% (to \$575 for Civics). The credit for these cars is eliminated in 2009.

You can check out all hybrids on line at: www.fueleconomy.gov. Check it out for yourself. (Click on "Hybrid Vehicles/Tax Incentives").

If you are subject to the AMT – Alternative minimum tax – the hybrid tax credit is not allowed at all under AMT rules.

SEE YOU NEXT MONTH



**APPLICATION FOR MEMBERSHIP IN
THE ARKANSAS SOCIETY OF
ACCOUNTANTS**

P.O. Box 725
Newport, Arkansas 72112
asalaverne@hughes.net
www.arspa.org

Last Name _____ First Name _____ Middle Initial _____ Business Phone _____ Home Phone _____

Business Address _____

How many years of accounting have you had? _____ Date of Birth _____

Sole Practitioner [] Partner [] Employee [] Corporate Officer []

Name of Firm _____ Number of Employees _____

Name of Partner(s) _____

Are you a Licensed, Registered or Certified Public Accountant? _____ If yes, give License# _____

Are you an Accredited Public Accountant? _____ If yes, give Accreditation # _____

Are you an Enrolled Agent _____ If yes, give EA # _____

Do you hold an Associate or Baccalaureate degree with a minimum of 24 semester hours in Accounting? Yes _____ No _____

Are you engaged in any other trade or profession? _____ If yes, please describe _____

Please list other accounting organizations in which you hold membership: _____

I hereby state that the accompanying statements are correct to the best of my knowledge and belief. I further state that I will abide by the Constitution and By-Laws of the Society and will practice in strict conformity with the Code of Ethics and Rules of Professional conduct adopted by the Society.

Date _____ Signature of applicant _____

Annual dues are payable IN FULL in advance and are prorated for credit by ASPA on a monthly basis to August 31 - the end of ASPA's fiscal year.

[] Membership Annual Dues \$85.00 [] Firm Annual Membership \$50.00 [] Diamond State Annual Dues \$15.00
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LaVerne Long /EXECUTIVE SECRETARY

EXECUTIVE OFFICES:

5725 HWY 18 E. • P.O. BOX 725

NEWPORT, AR 72112

PHONE 870-523-5329 • FAX 870-217-0154

www.arspa.org

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