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Tax & Business Alert

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IN DOWN YEARS, NOL RULES CAN OFFER TAX RELIEF

From time to time, a business may find that its operating expenses and other deductions for a particular year exceed its income. This is known as incurring a net operating loss (NOL).

In such cases, companies (or their owners) may be able to snatch some tax relief from this revenue defeat. Under the Internal Revenue Code, a corporation or individual may deduct an NOL from its income.

3 WAYS TO PLAY

Generally, you take an NOL deduction in one of three ways:

1. Deducting the loss in previous years, called a "carryback," which creates a refund,
2. Deducting the loss in future years, called a "carryforward," which lowers your future tax liability, or
3. Doing a little bit of both.

A corporation or individual must carry back an NOL to the two years before the year it incurred the loss. But the carryback period may be increased to three years if a casualty or theft causes the NOL, or if you have a qualified small business and the loss is in a presidentially declared disaster area. The carryforward period is a maximum of 20 years.

DIRECTION OF TRAVEL

You must first carry back losses to the earliest tax year for which you qualify, depending on which carryback period applies. This can produce an immediate refund of taxes paid in the carryback years. From there, you may carry forward any remaining losses year by year up to the 20-year maximum.

You may, however, elect to forgo the carryback period and instead immediately carry forward a loss if you believe doing so will provide a greater tax benefit. But you'll need to compare your marginal tax rate — that is, the tax rate of the last income dollar in the previous two years — with your expected marginal tax rates in future years.

For example, say your marginal tax rate was relatively low over the last two years, but you expect big profits next year. In this case, your increased income might put you in a higher marginal tax bracket. So you'd be smarter to waive the carryback period and carry forward the NOL to years in which you can use it to reduce income that otherwise would be taxed at the higher rate.

AMT EFFECT

One tricky aspect of navigating the net operating loss (NOL) rules is the impact of the alternative minimum tax (AMT). Many business owners wonder whether they can offset AMT liability with NOLs just as they can offset regular tax liability.

The answer is "yes" — you can deduct your AMT NOLs from your AMT income in generally the same manner as for regular NOLs. The excess of deductions allowed over the income recognized for AMT purposes is essentially the AMT NOL. But beware that different rules for deductions, exclusions and preferences apply to the AMT. (These rules apply to both individuals and corporations.)

Then again, as of this writing, efforts are underway to pass tax law reform. So, if tax rates go down, it might be more beneficial to carry back an NOL as far as allowed before carrying it forward.

WHATEVER THE REASON

Many circumstances can create an NOL. Whatever the reason, the rules are complex. Let us help you work through the process. ■

ASKING THE RIGHT QUESTIONS ABOUT LONG-TERM CARE INSURANCE

Like most people, as you age into your 40s and 50s, you may wonder what the future holds for your health and well-being. Will you be as sharp mentally and robust physically as you are right now? Could a serious medical condition arise in your future that might prevent you from performing routine daily tasks?

Unfortunately, many of us require long-term care (LTC) at some point in our lives. To hedge against this considerable financial risk, insurers offer LTC coverage.

DO YOU REALLY NEED IT?

LTC insurance policies help pay for the cost of long-term nursing care or assistance with activities of daily living (ADLs), such as eating or bathing. Many policies cover care provided in the home, an assisted living facility or a nursing home, though some restrict coverage to only licensed facilities. Without this coverage, you'd likely need to pay these bills out of pocket.

Medicare or health insurance generally covers such expenses only if they're temporary — that is, during a period over which you're continuing to improve, such as recovering from surgery or a stroke. Once you've plateaued and are unlikely to improve further, health insurance or Medicare coverage typically ends.

That's when LTC insurance may take over. But you need to balance the value of LTC insurance benefits with the cost of premiums, which can run several thousand dollars annually (though a portion may be tax deductible). Depending on your income and net worth, as well as your personal and family health history, LTC insurance may not be a worthwhile investment.

SHOULD YOU BUY NOW OR LATER?

The younger you are when you buy a policy, the lower the premiums typically will be. And, the chance of being declined for a policy increases with age. Certain health conditions, such as Parkinson's disease, can also make it more difficult, or impossible, for you to obtain an LTC policy. If you can still get coverage, it likely will be much more expensive.

So buying earlier in life may make sense. But, keep in mind you'll potentially be paying premiums over a much longer period. You can often trim premium costs by choosing a longer elimination period or a shorter benefit period.

The elimination period is the amount of time between the start of the benefit trigger and the time that the policy begins paying benefits.

The elimination period is the amount of time between the start of the benefit trigger and the time that the policy begins paying benefits. This can range from 30 days to several months. Premium costs decrease as the elimination period increases.

Meanwhile, the benefit period is the period of time over which the policy pays for care. This can range from a year or two to an unlimited amount of time.

BOON OR BUST

Buying LTC insurance can be a boon or a bust. You should consider contacting our firm before making the purchase. We can help you determine whether LTC insurance is right for your situation and, if so, when to buy and the appropriate amount of coverage. ■

RENTING OUT YOUR VACATION HOME? ANTICIPATE THE TAX IMPACT

When buying a vacation home, the primary objective is usually to provide a place for many years of happy memories. But you might also view the property as an income-producing investment and choose to rent it out when you're not using it. Let's take a look at how the IRS generally treats income and expenses associated with a vacation home.

MOSTLY PERSONAL USE

You can generally deduct interest up to $1 million in combined acquisition debt on your main residence *and* a second residence, such as a vacation home. In addition, you can also deduct property taxes on any number of residences.

If you (or your immediate family) use the home for more than 14 days and rent it out for less than 15 days during the year, the IRS will consider the property a "pure" personal residence, and you don't have to report the rental income. But any expenses associated with the rental — such as advertising or cleaning — aren't deductible.

MORE RENTAL USE

If you rent out the home for more than 14 days *and* you (or your immediate family) occupy the home for more than 14 days or 10% of the days you rent the property — whichever is greater — the IRS will still classify the home as a personal residence (in other words, vacation home), but you will have to report the rental income.

In this situation, you can deduct the personal portion of mortgage interest, property taxes and casualty losses as itemized deductions. In addition, the rental portion of your expenses is deductible up to the amount of rental income. If your rental expenses are greater than your rental income, you may not deduct the loss against other income.

If you (or your immediate family) use the vacation home for 14 days or less, or under 10% of the days you rent out the property, whichever is greater, the IRS will classify the home as a rental property. In this instance, while the personal portion of mortgage interest isn't deductible, you may report as an itemized deduction the personal portion of property taxes. You must report the rental income and may deduct all rental expenses, including depreciation, subject to the passive activity loss rules.

BRIEF EXAMINATION

This has been just a brief examination of some of the tax issues related to a vacation home. Please contact our firm for a comprehensive assessment of your situation. ■

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THOUGHTS AND MUSINGS ON FAMILY BUDGETING

Simplicity is the key to a successful family budget. But every budget needs to cover all necessary items. To find the right balance, your budget should address two distinct facets of your family members' lives: the near term and the long term.

In the near term, your budget should encompass the primary, day-to-day items that affect every family. First, housing: This is often the biggest expense in a family budget. And a budget shouldn't include only mortgage or rent payments, but also expenses such as utilities, furnishings, maintenance and supplies.

Naturally, there are other items related to daily life for which you need to account. These include groceries, vehicle and transportation expenses, clothing, child care, insurance and out-of-pocket medical expenses. And you need to draw clear distinctions between fixed and discretionary spending.

Along with being a practical guide to family spending, a budget needs to address long-term goals. Naturally, some goals are further out than others. One of your longest-term objectives is probably to retire comfortably. So the budget should incorporate retirement plan contributions and other ways to meet this goal.

A relatively less long-term goal might be funding your children's education. So, again, the budget should reflect this. And, as a long-term but "as soon as possible" objective, the budget needs to be structured to pay off debt and maintain a strong credit rating.

Only through careful planning and discussion can families build a budget that addresses both daily finances and long-term financial goals. We can help you get started. ■