Congress passes 1099 repeal: Old rules still apply

TAX: Bill repeals 1099 reporting to corporations and by landlords.

By Tim Hilger, CPA
Editor

On April 5, 2011, the Senate approved a bill¹ to repeal expanded 1099 reporting for certain business payments and rental property expense payments. At press time, the President was expected to sign the bill.

Business reporting
The Patient Protection Act² Act provided for two new rules for 1099 reporting:
• 1099s would be required for purchases of goods (and not just services); and

Rental reporting
Under the Small Business Jobs Act,³ landlords were required to file 1099s for payments to service providers aggregating

IRS clarifies Medicare premiums for self-employed health insurance deduction

TAX: Guidance gives the “OK” to filing amended returns.

By Tim Hilger, CPA
Editor

The IRS has finally issued Publication 535, clarifying certain issues regarding the deductibility of Medicare premiums for purposes of the self-employed health insurance deduction.¹

Other premiums and amended returns
The new guidance gives the green light to two other opportunities that weren’t resolved with previous guidance:
• Medicare premiums other than Part B are also deductible; and

• Amended returns can be filed for prior years.
Publication 535 states, "Medicare premiums you voluntarily pay ... can be used to figure the deduction." As the statement does not limit the deduction to just Part B premiums, it appears that other Medicare premiums, such as Part D, can also be deducted.

The publication goes on to say, “If you previously filed a return without using Medicare premiums to figure the deduction, you can file an amended return to refigure the deduction.” It appears that you can file an amended return for any year open under the statute of limitations for qualifying premiums paid in earlier years. This is the answer we anticipated since the underlying law did not change.³

Earlier guidance
Contradicting their previous stand on the issue and without fanfare, the IRS said in the

See Medicare, page 2

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Support for your parents and children as taxable gifts

By Richard B. Malamud, CPA, J.D., LL.M.
Guest Contributor

The good news: Providing the support for your parents or adult children often allows you to claim a dependency exemption if you provide over half of their support and their gross income is less than the exemption amount ($3,700 in 2011).1

EXAMPLE 5-4: Your son, Joe, graduated from college two years ago and can’t find work. You sent him $20,000 to pay for his rent, car, insurance, etc. He earned $2,000 from a part time job. Joe is your dependent.

EXAMPLE 5-5: Mom is retired and lives on $8,000 from Social Security. You send her $1,500 a month. Since she has no gross income and you provided more than half of her support, she is your dependent.2

The bad news: If your generosity exceeds the $13,000 annual gift tax allowance, you may have made a taxable gift. Of course no one realizes this, maybe not even the IRS, even though all gratuitous transfers are presumably taxable gifts.

Gift tax applies whenever there is a voluntary transfer of property without consideration or compensation. Except for gifts to spouses,3 most family transfers are taxable gifts, except that it is pretty much universally accepted that the gift tax does not apply to transfers that are pursuant to a legal support obligation.4 This is so obvious that it does not require an explicit statutory provision.5

If it isn’t support, it is a gift

If you are not required to support your adult child or parents is it a taxable gift? Apparently the IRS thinks it is.

EXAMPLE 5-6: Mom pays $25,000 for her 30 year old son’s college tuition and $22,000 for room and other expenses. If she lives in Hawaii and is a noncustodial parent, she may be able to argue this is a legal support obligation and not a gift. In Michigan, she’s probably made a taxable gift of $9,000 ($22,000 less $13,000).6

If it is support, it probably isn’t a gift

There may be hope if the payment is a required support obligation. A proposed regulation that was never adopted stated “… expenditures … in satisfaction of (one’s) legal obligation to provide … support are not taxable gifts.”7 If this were the law, then children who are legally required to provide support to their parents or parents for their adult children would not be making taxable gifts.

Thirty states require children to support their parents if the parents are indigent and the children can afford it. For example, Cal. Family Code §4400 states, “… an adult child shall, to the extent of his or her ability, support a parent who is in need and unable to maintain himself or herself by work.” Some states also require support for adult children. Penn. Domestic Relations §4603 provides that a spouse, a child, or a parent of an indigent person may be required to financially assist that person.8

College for adult children

When your adult non dependent children are in college, tuition paid directly to the school is not a taxable gift. But what about the room and board, books, car, and other things? These are probably taxable gifts. However, as one online article says, many states require non-custodial parents to provide college expenses. Those states include Alabama, Connecticut, the District of Columbia, Hawaii, Illinois, Indiana, Iowa, Massachusetts, Mississippi, Missouri, New Hampshire, New Jersey, New York, North Dakota, Oregon, South Carolina, Utah, and Washington.11

States that currently have statutes requiring children to support their parents are: Alaska, Arkansas, California, Connecticut, Delaware, Georgia, Idaho, Indiana, Iowa, Kentucky, Louisiana, Maryland, Massachusetts, Mississippi, Montana, Nevada, New Hampshire, New Jersey, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Utah, Vermont, Virginia, and West Virginia.9

Unfortunately, the IRS still believes everything else continues to be a taxable gift. Rev. Rul. 82-98 clarified that the new law only applied to medical and tuition payments. It stated that when a parent provided for mortgage payments of an adult son who was injured in an automobile accident, a taxable gift resulted. Almost 30 years later, no new guidance has been issued, yet the IRS hasn’t told single parents who pay their child’s college costs to file gift tax returns, even though room and board, books and supplies, and spending money often far exceed the $13,000 per year annual exclusion.

It is not clear if the IRS will follow this gift tax exclusion. These laws are rarely if ever enforced, so they could argue this isn’t state required support. In addition, there is an old California case in which the IRS refused to follow local law in this area.10 For those in other states, since support is not legally required, they have made a gift. It should be noted that federal law bars states from using this financial responsibility (except for a spouse) as a basis for denying Medicaid or other poverty programs.11

See Taxable, page 9
Curing excess contributions to an IRA doesn’t have to be painful

By Tim Hilger, CPA

Editor

A client recently told me, “I rolled over my mutual funds into a Roth.” I knew that she didn’t have an IRA and, in fact, had never qualified to make an IRA contribution.

IRAs have become increasingly prevalent and are firmly implanted in the public consciousness. It is becoming more and more common for individuals to think that they can always make IRA contributions; in fact, the only limitation commonly understood by members of the general public is the $5,000 limit. It is far less common for clients to understand:

- The earned income limits;
- The active participation limits and other rules that affect deductibility; and
- The age 70½ limit for contributions to traditional IRAs.

EXAMPLE 5-7: Harry is anxious to make his IRA contribution early in the year so he can start enjoying tax-deferred earnings as soon as possible. He makes his $5,000 contribution on January 1, 2010. Unfortunately, Harry is laid off from his job on January 10, 2010, and does not find another job for the rest of the year. His W-2 income is $3,000, so, based on his taxable compensation limit, his maximum IRA contribution is $3,000. He has a $2,000 excess contribution.

On February 10, 2011, Harry requests a return of the $2,000 plus allocable earnings.

At the time he made the $5,000 contribution:

- Account value (including $5,000 contribution) $20,000
- Value at time of removal $22,000

Harry has $200 of earnings attributable to the excess contribution calculated as follows:

$2,000 × ($22,000 - $20,000) ÷ $20,000 = $200

Harry must remove $2,200 from the account ($2,000 excess contribution plus $200 earnings). He is under age 59½, so the earnings are subject to the 10% additional tax.

Harry will deduct $3,000 as an IRA contribution. He must include $2,200 on Form 1040, line 15a, and $200 on line 15b.

With all the publicity regarding Roths over the last year, the newest misconception is that the income limits have been eliminated on Roth and other IRA contributions. In fact, only the limit on conversions has been eliminated.

Any contribution above the allowed amount is an “excess contribution” and may be subject to a 6% penalty. Fortunately, if the error is discovered early enough the penalty can be avoided. In fact, there are instances, as we’ll see, in which paying the penalty might be the best course of action.

The Internal Revenue Code describes the three strategies to deal with an excess contribution:

- Withdraw the excess by the due date of the return;
- Withdraw the excess after the due date of the return; or
- Withdraw the excess and pay the penalty at a later date.

**About the author**

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1 IRC Section 152(d)(1)(B). For qualifying children, those under 19 or under 24 and a full time student, there is no gross income limitation. Other tests must also be met.

2 She may also qualify you as Head of Household if you are single. IRC Section 2(b)(1)(B)

3 IRC §2523


5 Boris I. Bittker & Elias Clark (1990) Federal Estate and Gift Taxation 73

6 IRC Section 2503(e)


8 See Requiring Adult Children to Pay for College Tuition. See www.mrcustodycoach.com/blog/require-non-custodial-parent-pay-college-tuition

9 Unfortunately, it isn’t clear if DOMA (the Defense of Marriage Act) affects this conclusion. 1 USC §7

**Conclusion**

Generous parents and children who support their adult family members have probably made taxable gifts, unless they are required to pay that support under state law. Most of those taxpayers do not realize they may have made taxable gifts. With college room and board well over $13,000 per year, the failure of the IRS to remind us of the old rulings means that at a minimum, this is not a high priority issue with the IRS. But that doesn’t mean it isn’t a gift. It would be nice if Congress expanded the medical and tuition exception to payment for items like rent, food, and insurance for those with little or no net worth.

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TAX: With all the talk about Roth conversions, many clients who don’t qualify make contributions anyway.

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