

Client Information Bulletin

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Eight Key Deductions for Landlords to Latch Onto

Don't miss out on tax breaks for rental properties

Do you own valuable rental property? All too often, landlords don't take every deduction they are eligible to claim on their return. Here are eight deductions that can offset rental income you receive from your real estate holdings.

1. Interest: This is usually the biggest deduction on the list. You can deduct mortgage interest on loans to acquire or improve your rental property plus other interest incurred for assets or services used in the rental activity.

2. Depreciation: Most likely, this is the second-biggest deduction item. Recover the cost of the property through annual depreciation deductions based on the basis in the property. Residential rental property must be depreciated over a period of 27½ years.

3. Repairs: The cost of "ordinary and necessary" repairs is deductible in the year in which they are incurred. These include expenses for repainting, fixing gutters and leaks, plastering and replacing broken windows. **Note:** The cost of improvements, as opposed to repairs, must be capitalized and added to your basis.

4. Insurance: You can deduct insurance premiums for your rental property including fire, theft, flood and landlord liability insurance. And, if you have regular employees,

you can also write off the cost of health insurance and workers' compensation insurance.

5. Salaries and contractor fees: When you hire someone to work for your rental activity, you can deduct his or her wages as a business expense. Similarly, you can deduct fees paid to independent contractors—for example, a plumber or landscaper—to provide services for your operation.

6. Local travel: Don't forget to keep track of auto or truck expenses that are related to rental activity. This is not limited to travel to and from the rental property; for instance, you can also deduct trips to the hardware or office supply stores. For simplicity, use the standard mileage rate (see back page) to figure out your deduction.

7. Professional fees: Generally, you can deduct the fees paid to professionals—attorneys, accountants, property management companies, investment advisors and the like—to the extent the costs are attributable to your rental activity.

8. Casualty losses: Finally, if your rental property is damaged or destroyed by a sudden event, including vandalism or theft, you may be able to claim a casualty loss for the damage suffered (less insurance reimbursements). **Note:** As

Inside

***New Concerns for
Employers About ID Theft***

***Biweekly Mortgages:
The Numbers Game***

***How to Inspire Your
Part-timers***

***IRS Boosts the
Standard Mileage Rate***

was the case with Hurricane Katrina, special tax relief is available to property owners in federally designated disaster areas.

It makes perfect sense to claim every last tax deduction allowed under the law. Don't hesitate to seek professional assistance in this area.

New Concerns for Employers About ID Theft

Liability may be extended due to employee actions

Warning: A new case shows that employers could be held legally liable for identity (ID) theft resulting from the actions of one of its employees. This outcome, when combined with recently enacted federal legislation, should give employers cause for concern.

Before we discuss the new legislative requirements, let's take a look at the new case decided by the Michigan Court of Appeals.

Facts of the case: A union treasurer was working at home with documents containing the names and Social Security numbers of other union members. Without the treasurer's knowledge, his daughter stole the data and used it to commit ID theft against over a dozen union members. The jury determined that the union was negligent for failing to adequately safeguard the personal information from theft.

In its appeal, the union argued that it should not be held liable for the "unforeseeable" criminal acts committed by a third party who was not an employee of the organization. However, under the prevailing law in Michigan, this legal doctrine does not apply if there is a **special relationship** between the parties.

The Court determined that a special relationship did in fact exist based on these factors:

- ◆ Since the union was the legal representative of the plaintiffs, it had an obligation to act in their best inter-



ests by safeguarding their personal information.

- ◆ The union was in a better position than its members to control access to the personal information that was used to commit ID theft.

- ◆ The risk to sensitive information stored in an unsecured environment, such as a personal residence, was foreseeable because of the increasingly prevalent threat of ID theft. The severity of the

potential harm was substantial due to the monetary concerns surrounding the theft.

- ◆ Despite the prevalence of ID theft, the union did not require any safety precautions for documents taken off the premises.

As a result, the union was held legally responsible for the ID thefts committed by the daughter of its treasurer.

This new case dovetails with the **Fair and Accurate Credit Transactions Act of 2003**—known as FACTA, for short. Under FACTA's "disposal rule," employers are required to dispose of records that can personally identify an employee. The law doesn't mandate the method of disposal, but suggests shredding paper files, deleting electronic files or using whatever reasonable means are necessary.

The new law applies to every business regardless of its size or nature of work. Failure to do so is punishable by federal civil fines up to \$2,500 per employee and possible class action lawsuits. **Note:** Other laws may apply to employers on a state level. For instance, several states restrict the use of Social Security numbers for identification purposes.

Obviously, it is important for an employer to put procedures in place for protection against ID theft. Being forewarned is being forearmed.



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Biweekly Mortgages: The Numbers Game

Figure out all the angles before you switch

Should you replace your conventional monthly mortgage with a biweekly mortgage? There is no easy answer to that question. It requires an in-depth analysis that factors taxes into the equation. **Reason:** Because you can generally deduct the full amount of qualified mortgage interest, your expected savings with a biweekly mortgage may not be as much as you think. Moreover, you have to make payments sooner, which can hamper cash flow.

That is not to say you should dismiss biweekly mortgages either. You just need to crunch all the numbers.

Basic premise: The standard monthly mortgage plan is cut-and-dried. You make payments on a monthly basis 12 times a year. If you opt for a biweekly mortgage, you are paying the lender every two weeks for a grand total of 26 payments a year. In effect, you are making a thirteenth monthly mortgage payment each year. As a result, you must come up with the cash sooner than usual, but your mortgage will be paid off faster.

One of the main attractions of a biweekly mortgage plan is that you pay less mortgage interest because of the amortization of the extra payments. That is where the savings come from.

Hypothetical example: You take out a 30-year mortgage for \$100,000 at a 6% interest rate. With a traditional mortgage, your monthly payment of principal and interest (i.e., not counting property taxes, insurance or any other costs) would be \$599.55. The biweekly payment comes to \$299.78. Over the term of the mortgage, you will save \$25,641.80 in interest and pay off the loan more than five years early.

However, do not forget that mortgage interest is generally deductible on your personal tax return. For simplicity, we will assume you are in the 28% tax bracket for the length of the mortgage. By reducing your mortgage interest payments, you are forfeiting an extra \$7,179.70 in tax deductions (28% of \$25,641.80), reducing your net savings by that amount. The net savings will be even smaller if you are in a higher tax bracket in some or all of those years.

Note: A portion of your mortgage interest deductions may be slightly reduced if you are in a higher tax bracket. For 2005, the reduction begins for taxpayers with an adjusted gross income above \$145,950. However, this tax provision is scheduled to be gradually eliminated, beginning in 2006. It goes completely off the books after 2009.

Putting taxes aside for a moment, a biweekly mortgage plan can place a greater strain on your personal budget. It is also siphoning away funds that might be used for other purposes such as income-generating investments.

As an alternative, you might prepay mortgage interest on your own. If you are not held to a strict biweekly regimen, you can add whatever amount you want each month or skip it entirely. This enables you to reduce the length of the mortgage and save money overall—on your own terms.



How to Inspire Your Part-timers

Part-timers often get the short end of the stick. So how can you inspire this group to perform better? Here are a few helpful suggestions.

- ◆ Conduct an orientation. Take the time to spell out the part-timer's job duties and any job restrictions (e.g., limits on personal phone calls).
- ◆ Establish a chain of command. Frequently, part-timers do not even know who their supervisor is. It is especially beneficial if the supervisor can "mentor" part-timers.
- ◆ Mix up job assignments. Don't overload your part-timers with all the grunt work. Give them a chance to spread their wings with more challenging work.
- ◆ Address any resentment issues with full-timers. Make sure they know the reasons why part-timers have been hired. If they are not threatened, it will improve office morale.
- ◆ Offer flexible hours. Many part-timers have special circumstances that require some understanding and cooperation. You are more likely to retain them if you can bend a little.
- ◆ Provide incentives. Part-timers are generally excluded from bonuses. If you cannot include them in your bonus program, develop other incentives (e.g., a higher-than-usual annual increase).

Best approach: Whenever possible, treat part-timers like regular full-time employees, inviting them to company functions and the like. This will lead to an improved working environment and greater productivity.



IRS Boosts the Standard Mileage Rate

Higher rate applies to last four months of 2005

As a result of a spike in gas prices, the IRS recently approved an increase in the standard mileage rate for business drivers in 2005. The rate for the last four months of this year is 48.5 cents per business mile—up 8 cents per mile from the rate of 40.5 cents for the beginning of the year.

Background: As a general rule, you may deduct the cost of using a car for business purposes (subject to certain limits for luxury cars). But you have to keep track of such fixed expenses as depreciation, gas, oil, tires, repairs, insurance, parking fees and tolls. Similarly, if you lease your car, you may be entitled to deductions for lease payments.

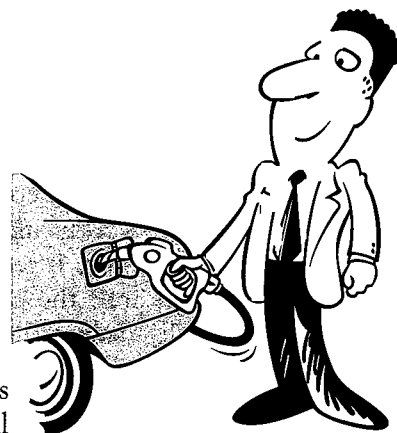
However, instead of deducting your actual automobile expenses, you can use the standard mileage allowance.

How it works: You simply deduct a flat rate based on your business mileage for the year. All of the costs of operating the car (including depreciation) are built into the standard mileage rate. In addition, you may deduct any business-connected parking fees and tolls.

The IRS adjusts the standard mileage rate almost every year. But it didn't wait until 2006 to boost the rate in the wake of escalating gas prices.

Example: Ms. Jones drives 1,000 business miles a month—or 12,000 miles per year—and incurs \$500 in business-related parking fees and tolls. If she uses the standard mileage rate method, Jones can deduct \$3,240

for the first eight months of the year (8,000 miles × 40.5 cents) and \$1,940 for the last four months of the year (4,000 miles × 48.5 cents). When you add in the \$500 in tolls and parking fees, her total 2005 deduction with this tax short-cut is \$5,680 (\$3,240 + \$1,940 + \$500).



Note: You cannot use the standard mileage allowance under certain conditions, including the following:

- 1.** You own the car and you have used a method of depreciation other than straight-line depreciation in a previous year (including the Section 179 allowance). For a leased car, you must use the standard mileage allowance for the entire lease period.
- 2.** You operate two or more cars at the same time for business purposes (e.g., fleet operations).
- 3.** The car is used for hire (e.g., a taxicab or limo service).

Should you take the tax shortcut or not? It depends upon your personal circumstances. While deducting your actual expenses may produce a larger deduction, there are additional recordkeeping requirements. In any event, unreimbursed employee business expenses are deducted as miscellaneous expenses (subject to a 2% floor).

Facts and Figures

Timely points of particular interest

➔**Tax Court Lesson**—You cannot deduct business education costs that qualify you for a new trade or business. Normally, this applies to master of business administration (MBA) degrees. However, in a new case, a salesman with some marketing experience was promoted soon after he entered an MBA program. In this case, the Tax Court permitted the employee to deduct the cost of obtaining the degree. With his prior experience, it did not qualify him for a new trade or business.

➔**Hurricane Relief**—The IRS has announced a special program designed to encourage aid to victims of Hurricane Katrina. Employees can donate unused vacation time, sick leave or personal leave. The time will be converted into cash payments to be distributed to qualified charities. Employees will not have to include the donated leave in taxable income, while employers can deduct payments made before 2006.