

CLIENT LINE

Curtis H. Finch, CPA, PC 770-998-6665 curtis@lowtaxcpa.com

JULY 2011

Social Security Myths vs. Facts

It's broke! (It isn't.) It's not fixable! (It is.) Here's what critics keep getting wrong about the future of Social Security

BY LIZ WESTON, AARP

• I've been writing about Social Security for nearly two decades. But even I still have trouble wrapping my brain around some of the system's complexities—from how benefits are calculated to how the trust fund works. So it's not surprising that myths about Social Security persist. With the debate about Social Security's future once again heating up, these three myths need to be put to rest—so we can focus on the real issues.

.By the time I retire, Social Security will be broke.

If you believe this, you are not alone. More and more Americans have become convinced that the Social Security system won't be there when they need it. In an AARP survey released last year, only 35 percent of adults said they were very or somewhat confident about Social Security's future.

It's true that Social Security's finances need work, because over the long term there will not be enough money to fully cover promised benefits. But radical changes aren't needed. In 2010 a number of different proposals were put forward that, taken in combination, would put the program back on firm financial ground for the future, including changes such as raising the amount of wages subject to the payroll tax and benefit changes based on longer life expectancy.

The Social Security trust fund assets are worthless.

Any surplus payroll taxes not used for current benefits are used to purchase special-issue, interest-paying Treasury bonds. In other words, the surplus in the Social Security trust fund has been loaned to the federal government for its general use—the reserve of \$2.6 trillion is not a heap of cash sitting in a vault. These bonds are backed by the full faith and credit of the federal government, just as they are for other Treasury bondholders.



However, Treasury will soon need to pay back these bonds. This will put pressure on the federal budget, according to Social Security's board of trustees. Even without any changes, Social Security can continue paying full benefits through 2037. After that, the revenue from payroll taxes will still cover about 75 percent of promised benefits.

I could invest better on my own.

Maybe you could, and maybe you couldn't. But the point of Social Security isn't to maximize the return on the payroll taxes you've contributed. Social Security is designed to be the one guaranteed part of your retirement income that can't be outlived or lost in the stock market. It's a secure base of income throughout your working life and retirement. And for many, it's a lifeline. Social Security provides the majority of income for at least half of Americans over age 65: it is 90 percent or more of income for 43 percent of singles and 22 percent of married couples. You can, and should, invest in a retirement fund like a 401(k) or an individual retirement account. Maybe you'll enjoy strong returns and avoid the market turmoil we have seen during the past decade. If not, you'll still have Social Security to fall back on.



TAX REFORM ON THE WAY OUT

The Obama administration is working on a proposal to revamp corporate taxes, but officials say they will not release any ideas on tax overhaul until after discussion about the economy and the deficit have been completed.

On the individual side, the notorious alternative minimum tax would be scrapped permanently. The same goes for the phase out of itemized deductions and personal exemptions for upper income filers. On the lower income side, the earned income credit and child tax credits are proposed to remain in the law.

Obama's fiscal commission on tax reform is proposing a severe limitation on mortgage interest and charitable contributions. Only interest on mortgages of up to \$500,000 on primary residences would be eligible. Home equity lines and mortgages on second homes and vacation properties would be scrapped. For charitable contributions, they would move into the 2% adjusted gross income categories. Other itemized deductions are proposed to be mixed including state sales and income taxes.



Back Up Your Tax Records

You can protect your records by making sure that they are backed up in and kept in a safe place. While a fire safe can be one way to help protect your documents, most people don't have a safe big enough for seven years of tax records. Most fire safes are small, meant to hold essential identification documents, insurance policy documents and other papers. Digitize your records and store them on a flash drive or CD that can be kept in the small fire safe. Even if you don't have the originals, having copies is better than having nothing.

Scan your tax records into image or PDF that can be stored in an online backup. You can pay for online storage or you just email yourself copies of the documents. With your documents stored online, you can access them from anywhere as long as you have an internet connection.

Animal rescue taxpayer is entitled to much of her claimed \$12,068 in cat care expenses as a charitable deduction on her income taxes

A family lawyer who devoted most of her time outside of work to caring for feral cats, 70 to 80 at one time, in her Oakland, Calif. home is entitled to much of her claimed \$12,068 in cat care expenses as a charitable deduction on her 2004 income taxes, according to a recent Tax Court case. Basically, the case says that unreimbursed volunteer expenses, to the extent they are incidental to charitable work for a qualified charity and are properly substantiated, are deductible.

"It's a huge win for all the rescue people out there," says the cat lady, Jan Van Dusen. "The judge was really nice. He understands what we do. We all go broke doing this."

The Internal Revenue Service had denied Van Dusen's entire deduction, stating that her expenses were personal and not rendered on behalf of a qualifying charity. The Tax Court, however, found that she worked for 501(c)(3) charities, primarily Fix Our Ferals, but also Island Cat Resources and Adoption, Berkeley East Bay Humane Society, East Bay Society for The Prevention of Cruelty to Animals, and Second Chance Cat Rescue.

Van Dusen trapped feral cats and took care of them in her 1,400 square-foot home until she could return them to the wild or adopt them out. Each day she fed, cleaned and looked after the cats. She laundered the cats' bedding and sanitized the floors, household surfaces and cages. She paid third parties for veterinary services, pet supplies and cleaning supplies.

The Court concluded that 90 percent of the veterinary and pet supply expenses and that 50 percent of the cleaning supply and utility expenses were attributable to Van Dusen's care for foster cats and not personal (she had 7 pet cats) and therefore potentially deductible.

Then the Court considered the substantiation requirements for claiming a charitable deduction. The Court divided her expenses into two pots: expenses of less than \$250 and expenses of \$250 or more. For the first category, you generally need a canceled check or other "reliable written record" as proof for a charitable deduction. In this case the Court accepted carbon copies from Van Dusen's check book, credit card statements, an account history from a pet hospital, and utility invoices.

Van Dusen had charges to a hardware store and Lowe's where she said she bought bags of wood stove pellets to use as cat litter, and although Van Dusen no longer had the itemized receipts, the Court allowed bank statements that showed the total purchase price if the total was an exact multiple of the price of one bag of pellets. (Ideally, you want a receipt that lists the items you purchased.)

For the expenses of \$250 or more, the Court denied the deductions because Van Dusen did not have a contemporaneous letter from a charity acknowledging that she expended the funds on its behalf. These big-ticket expenses, mostly bills to the Thornhill Pet Hospital and the St. Louis Vet Clinic, totaled just over \$5,000. Van Dusen said she didn't know about the extra requirements for the expenses of \$250 or more until she was audited. You need to have a substantiation letter from the charity on or before the earlier of the date you file your return or the due date (including extensions) for filing the return.

Penalty Abatement

Penalty abatement allows an individual to dispute interest and penalties for a certain period of time based on several reasons:

Reasonable Cause - If you weren't aware fully of tax law code, had a death in the family, have a serious illness or weren't able to file, you would qualify for penalty abatement.

Administrative Waivers- If you have had an unfortunate hardship like bad advice from a tax professional, natural disaster, death in the family, first time filing taxes, fixed income, mental diagnoses, lengthy unemployment, lost or destroyed financial records, drug or alcohol problems.

IRS Error - If the IRS made a mistake on the processing of your claim or if the IRS gave you bad advice on how to file your taxes.

YOUR SUMMER/FALL TAX CALENDAR

August 15th

July monthly payroll tax deposits for IRS & State

September 15th

August monthly payroll tax deposits for IRS & State

September 15th

Corporate 2010 returns extended in March due.
Third quarter 2011 estimated taxes due

The purpose of this newsletter is to provide current information on tax, financial and business developments and to suggest general tax planning ideas that may be appropriate in certain situations. The opinions are generalizations and may not apply to all taxpayers, so it is important that you seek our professional advice before implementing any tax strategies mentioned in this publication.