

# INDIVIDUAL INSIGHTS

A SEMIANNUAL NEWSLETTER FROM  
ANDERSON ZURMUEHLEN & CO., P.C.

FALL 2010

## Excluding Gain on the Sale of a Principal Residence

When you sell your house, you can exclude some or all of the gain if you meet certain requirements. The general rule is if you've owned and used your house as your principal residence for two out of the last five years and haven't sold a principal residence in the last two years prior to the current sale, you can exclude up to \$250,000 of gain (\$500,000 for married individuals filing jointly).

Beware: The gain exclusion rule changes if you've used part of your house for a home office or business and have been depreciating that portion of your house. There are also some new rules you must consider if you're selling a vacation home or rental property you've since converted to your principal residence.

**Sale of principal residence, business use within the residence:** Suppose you've been using a spare bedroom for the last three years as a music studio and have taken depreciation, or could have taken depreciation, in the amount of \$1,000. This has to be reported as gain and taxed. Any remaining gain is still excluded. Additionally, the gain on depreciation is taxed potentially at a higher rate than the

typical capital gain rate of 15%.

**Sale of principal residence, business use on a separate portion of the property:** Instead of using a spare bedroom, you've run the studio out of a detached mother-in-law apartment behind the house. If this is the case, you have to allocate the sales proceeds between the principal residence and the mother-in-law apartment and calculate the gain for each separately. Gain from the sale of the mother-in-law apartment will be taxable; gain from the sale of the principal residence will be excluded if the normal rules are met.



**Rental or vacation home converted to principal residence:**

There is no gain exclusion for rental or vacation property since neither qualifies as your principal residence. If you move into your rental or vacation home, make it your principal residence, live there for at least two years and sell the property, the amount of gain that is taxed is based on a ratio considering the amount of time the property was a rental or vacation home versus a primary residence. Time prior to January 1, 2009 that the property was used as rental or vacation property is not counted in determining the ratio to calculate the taxable and excludable gain.

Due to the **general gain exclusion rule**, most people never pay tax on the gain when they sell their house. If there has been some use of the house other than as a principal residence, a portion of the gain will be taxable. Your tax consultant at Anderson ZurMuehlen will help you navigate the rules when you sell your home. ■

Contributing authors:

Parker Dalberg  
Heather Hudson  
David Lowen  
Krystal Stewart  
Shirlee Walker  
Norm Williamson



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|----------------|--------------|
| BILLINGS ..... | 406.245.5136 |
| BOZEMAN .....  | 406.556.6160 |
| BUTTE .....    | 406.782.0451 |
| HELENA .....   | 406.442.1040 |
| MISSOULA ..... | 406.721.7800 |

# Paper, Plastic, or Electronic?

**A**re you tired of writing paper checks for your taxes when you pay all your other bills electronically? If so, you may be very interested in the options described below.

## Making Federal Estimated Tax Payments

Most taxpayers already know they can use direct deposit to receive their federal tax refunds and that automatic withdrawal can be used to make tax payments instead of sending a check on April 15th. What many people don't realize is that the same system businesses utilize to pay their payroll taxes and make corporate tax payments—the Electronic Federal Tax Payment System (EFTPS)—can be used by individuals to make their quarterly estimated income tax payments.

A free service from the Department of the Treasury, EFTPS allows you to make payments online or by phone any time you want. It also permits you to schedule an individual payment up to 365 days in advance. This means that when we send you the schedule of your estimated tax payments, you can use EFTPS to preschedule the payments online for the rest of the year. For those who take advantage of this service, forgetting to make estimated tax payments on the specified due dates quickly becomes a thing of the past.

It's easy to enroll. Simply go to [www.eftps.gov](http://www.eftps.gov), click on Enrollment, select Individual, and enter the requested information. You'll need your Social Security number, name and address as they appear on your tax return, bank routing number, and the

account number for the account that will be used to make payments. Once you enroll, you'll be sent a PIN and instructions in the mail, which you can then use to select a password for login to EFTPS. It's that simple.


## Paying Montana Individual Income Taxes

Paying the balance due on your Montana income tax return or making estimated tax payments to the Department of Revenue can also be done electronically, again saving you time, paper, and effort. If you have a balance due on your Montana individual income tax return, you can pay this amount over the Internet in one of three ways:

- Electronic funds withdrawal when e-filing your federal/state tax returns. For the amount due to be withdrawn from your bank account when your return is processed by the Montana Department of Revenue, your tax preparer must have your bank information when the return is filed.
- E-check. Paying by e-check is free.
- Credit Card. If you use a credit card, there's a small fee.

To pay your Montana estimated taxes electronically, you can use either Income Tax Express or Taxpayer Access Point (TAP). Both of these services are free and are found on the Montana Department of Revenue's website. Simply go to <http://revenue.mt.gov/forindividuals/electronic-filing/electronicfiling.mcp>x to find the links for both TAP and Income Tax Express. Both services require you to register and provide personal information. Once registered, you can continue to log in and pay your taxes electronically.

Income Tax Express allows you to pay your state taxes online using a credit card (for a small fee) or by direct withdrawal from a checking or savings account (free). You still must complete your tax forms and send them to the Montana Department of Revenue. This service is only for making payments. Registering for a TAP account allows you to access previously filed returns, show any balance due, make payments on your account, and view your account information (address, name, etc.).

Paying taxes electronically is a way to simplify what, for most people, is a less than welcome task. If this appeals to you, consider signing up for EFTPS for your federal taxes or for either of the local options—Montana Income Tax Express or TAP—to pay your Montana income taxes. And be sure you don't wait until the last minute; it takes a couple of weeks to receive your PIN from the Internal Revenue Service. 



# Tax Planning Uncertainty

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The tax breaks we have enjoyed for a number of years are set to expire at the end of 2010. If Congress doesn't pass a new tax bill, the pre-Bush tax law rates and rules will return January 1, 2011. This article provides an overview of the current tax rates and rules and discusses several possible scenarios for 2011.

## Current Rates

The current individual tax rates are 10%, 15%, 25%, 28%, 33%, and 35%. Your tax bracket is the rate at which your last dollar of income is taxed. Capital gains are taxed at 0% or 15%.

## Dealing with Uncertainty

Below are three scenarios currently being discussed that could produce a tax structure for 2011:

1. Congress could extend the current tax structure for another year. Capital gains and dividends would be taxed at 0% or 15%.
2. The first four tax brackets currently in effect could remain the same. The 33% bracket would change to 36% and the 35% bracket would change to 39.6%. Capital gains and dividends would be taxed at 20%.
3. Current tax laws could expire and revert to pre-Bush tax law rates and rules. The tax brackets would be 15%, 28%, 31%, 36%, and 39.6%. Capital gains would be taxed at 20% and dividends would be taxed at the highest rate for other income on the return.

Congress is adjourned due to the November elections; no one, of course, can predict how a lame duck Congress will deal with the issue when it reconvenes later in November. Under none of the scenarios listed above will tax rates in 2011 be lower than they are this year, particularly capital gains rates. If Congress does not act during the lame duck session or if it does act and raises capital gains tax rates and you're in one of the top two tax rates, you should be prepared to generate capital gains or accelerate income into this year to take advantage of the lower rates in 2010.


Take time over the next few weeks to meet with your tax advisor and identify opportunities to create capital gains. A key element in tax planning is determining the timing of discretionary income and expenses. Typically, we look at the current year tax rate structure and the following year tax rate structure. As previously noted, the current tax rates and rules are due to expire on December 31, 2010. Capital gains can be generated by selling stocks or other assets that are worth more than what you paid for them, or if you are involved in a closely held C corporation, paying dividends to shareholders before year end. Be sure to act before the end of 2010.

The current uncertainties will make year end planning more challenging. Contact your Anderson ZurMuehlen tax consultant to discuss your options. 

## As the Year Draws to a Close...

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There are a number of income and estate tax provisions that may or may not expire at the end of 2010, depending on Congressional action (or inaction). Here are some of the most important items you need to be aware of:

- **Itemized deduction phase-out:** For 2010, there's no income-based phase-out of itemized deductions or personal exemptions. Currently, the phase-out rules are set to return in 2011. This could make it more favorable to accelerate itemized deductions into the current year.
- **Roth IRA conversions:** 2010 is the only year you can take advantage of the two-year spread option, which allows you to recognize income from a 2010 conversion equally in 2011 and 2012.
- **Gift tax:** Although the gift tax lifetime exemption is currently \$1,000,000, the tax rate on taxable gifts is 35%.
- **Generation skipping tax (GST):** Transfers to grandchildren during 2010, while still being subject to the gift tax, are not subject to the GST tax.
- **2011 estate, gift, and generation skipping taxes:** The maximum rate for estate, gift, and GST transfers is currently scheduled to return to 55% in 2011, with an exemption of \$1,000,000. 

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[www.azworld.com](http://www.azworld.com)



**Anderson ZurMuehlen & Co., P.C.**  
Discovery Block  
828 Great Northern Boulevard  
PO Box 1040  
Helena, Montana 59624-1040

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## QuickBooks: Not Just for Business!

**D**o you dread gathering tax information for your accountant? Is it hard for you to remember what happened during the year? Does it take too much of your time to prepare for taxes?



QuickBooks is a great tool for gathering and organizing tax information. The best part is that it's fast, affordable, and easy to learn and use.

So what can QuickBooks do for you? Here are just a few ways it can reduce the stress of tax preparation. QuickBooks can:

- Reconcile bank and credit card accounts
- Attach documents for equipment, vehicle, and land purchases and other important transactions
- Track deductions for medical expenses, contributions, interest income, property taxes, job expenses, and other miscellaneous deductions (including gambling losses)
- Track the information you'll need to take advantage of tax

deductions and credits such as education expenses, energy credits, and retirement savings contributions

- Provide a year-to-year comparison of income and expenses
- Track and separate activities for rentals, businesses, farms, etc.
- Track activity throughout the year so you don't have to remember what happened
- Run year-to-date reports on expenses such as contributions and medical expenses
- Produce complete records in the event of an audit
- Save you time by recording transactions and printing checks at the same time
- Because all of your activity can be reviewed, it can help your accountant catch deductions that otherwise might be missed (child care expense, business expenses, etc.)

Anderson ZurMuehlen offers classes, webinars, conferences and one-on-one consulting for QuickBooks. Let us purchase the software for you, help you get set up, and show you how easy it is to get organized for tax time! 