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### **MORTGAGE DEBT, TAX GAIN ON SALE OF RESIDENCE**

With the recent sub-prime mortgage crisis many homeowners may unknowingly increase their tax bill upon the sale or foreclosure of their homes. Whether they took out a home equity loan with a teaser rate, or borrowed heavily to buy-in at the top of the market, they may be in for a big surprise.

The newspapers are filled with stories about recently purchased homes that have significantly declined in value. Combine that with an adjustable rate mortgage payment that is about to reset, and many homeowners may be forced to sell their homes.

The first consequence of a sale or foreclosure of your home is the gain or loss upon sale, which is determined by subtracting the original cost (plus any improvements) from the sales proceeds. A loss would not be deductible as it would be considered personal. A gain of up to \$500,000 (\$250,000 for single taxpayers) may be excluded under the home sale exclusion rules, if all of the requirements are met.

What about the mortgage balance in excess of the cash proceeds? If the lender forgives the excess it would be considered income to the borrower. However, insolvent taxpayers (and certain others) may be able to exclude this income from their taxes.

### **IMPROVE CASH FLOW BY FACTORING RECEIVABLES**

Growing companies may have cash flow difficulties due to extensive financing of their sales. Accounts receivable may improve the look of your balance sheet, but what should you do when you need the cash? Many small businesses turn to a little-known service called "factoring." Your business may sell its accounts receivable (with or without recourse) to a bank or fi-

ancing firm for immediate cash. The cash is received in as little as 24 hours, compared to the 30 days or longer it takes for your customers to pay.

The factor usually advances from 70 to 90 percent of the face value of the invoices. When payment is received the factor takes its fee, and pays your company the balance owed. The fees range from 3 to 5 percent, based on sales volume and the creditworthiness of your customers. A new business may use this service until it reaches its goal of becoming self-financing.

### **TAX DEDUCTIBILITY OF INVESTMENT FEES**

The IRS may be eliminating a tax-saving strategy used by thousands of taxpayers with brokerage accounts that charge a flat percentage fee (known as wrap accounts), as opposed to a per trade commission. The annual fees paid by investors (which can reach 3% of assets) are generally treated as miscellaneous itemized deductions, which are subject to a 2% of adjusted gross income (AGI) floor. This means that only the expenses which exceed 2% of AGI are deductible. The benefit of the tax deduction is further limited by the alternative minimum tax rules.

Under a little known rule, taxpayers may have the option of adding the fees to the basis of the securities acquired in the account. This would reduce the gain (or increase the loss) of the securities when sold. This option usually results in a lower tax bill. A recent memo issued by the IRS's Office of Chief Counsel may make this option more difficult for taxpayers to choose. This memo was aimed at assisting IRS agents regarding a specific taxpayer. However, tax practitio-

ners will rely on this publication due to a general lack of published guidance.

## MORE ON SALES OF YOUR HOME

Elder citizens often need to move into an assisted care facility or a family member's home at some point in their lives. One of the biggest issues they must deal with is what to do with their home, often their largest investment. The longer the home has been owned, the larger the appreciation and the bigger the tax issues become. The options are either to keep the home or to sell it. The decision depends upon their current and estimated future income needs, as well as any estate planning goals.

The home may be sold now in order to secure easier access to the cash in case of emergencies. If the requirements were met, all or a portion of the gain may be excluded from taxable income (see prior article). This tax savings represents a significant increase in the total assets of the homeowner.

Another option is to rent the home to generate a new income stream. Selecting a competent property manager would eliminate the day-to-day burden of managing the property. If the home were sold within 3 years the gain may also be excluded under the home sale exclusion rules. However, the homeowner must be cautious. He may intend to wait until the end of the 3-year period to sell, then due to unforeseen circumstances the property is not sold within the required time frame.

A third option for married couples is to delay selling the property until one of the spouses passes away. If the home were community property the surviving spouse would receive a full step-up in basis to the current fair market value (a separate property residence would only receive a step-up on half). A sale of the home shortly after that death would generally result in no taxable gain.

## LEASE REVIEWS

All businesses will likely grow, shrink or diversify over time. That means the current office lease they have negotiated may not suit their future needs. Effective negotiations will save the cost of relocating every time your business changes its size or direction.

You may also be able to generate extra revenue by subletting, so you may wish to periodically review all of the office leases, including those of your branches or divisions.

When you renew your lease you should consider these ideas:

- Ask the landlord for an improvement allowance or several months free rent. They would likely make similar concessions for a new tenant.
- Calculate your growth rate, then rent enough space to accommodate that growth. Make sure you are allowed to sublet the excess space until you need it.
- Always measure the floor space to ensure that you are getting everything you paid for.

## BEAR AND BULL MARKETS

Have you ever wondered where these two symbols of the U.S. stock market originated? Bear markets represent a prolonged decrease in the market, while bull markets represent prolonged upward trends. These two equally forceful creatures of the animal kingdom are synonymous with these two diametrically opposed market trends.

The symbol of the bear may have been the inadvertent result of stock manipulations by a London-based company in the early 1700s. The South Sea Company had many years of prosperity before its failure due to gross mismanagement. The stock had been sold and resold many times before it became worthless. As a result, England's economy and stock market became volatile, and an era of speculation was ushered in. Brokers known as "bearskin jobbers" began to sell skins before the animals were caught. This short-selling caused downward pressure on prices which journalists termed a "bear market."

The symbol of the bull may have come from the way it confronts its prey. The bull thrusts its horns up into its opponent. While a bear stands on its hind legs and swipes its arms downwards. Is it because these fierce opponents were pitted against each other in sporting events due to their opposite fighting styles? Whatever the reason, these symbols have been used to describe the U.S. markets since the late 1800s.

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