

Spring

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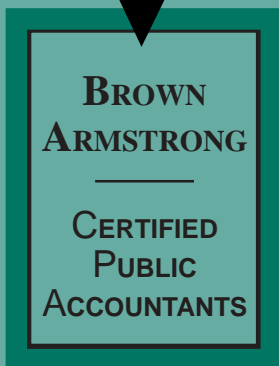
# FINANCIAL NOTES

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## New IRS Regulations On Principal Residence Sales Offer Opportunities

Before the federal tax law was modified in 1997, a homeowner who earned a profit from selling a principal residence could defer taxes on the gain by reinvesting the sales proceeds in a new home within two years before or after the sale. In addition, the law gave individuals age 55 or older a one-time opportunity to permanently exclude from income up to \$125,000 of gain on the sale of a home owned and used as a principal residence for three or more of the five years before the sale.

### Current Law

The current tax law works a little differently. Now, if you earn a profit when you sell your principal residence, you may be able to exclude up to \$250,000 of gain from income (\$500,000 on a joint return), regardless of whether you reinvest your money in a new home and regardless of your age.

In general, the exclusion is now available only once every two years, and only if you own and use the home as a principal residence for two of the five years before the sale. The ownership and use periods do not have to be concurrent, and the two years may consist of 24 full months or 730 days. The old gain deferral and age-55 rules generally do not apply to current home sales. However, gain you deferred on past home sales may have to be accounted for when you sell your current residence.

The IRS recently issued new regulations that address some of the nuances of the current law. The new regulations generally apply to sales taking place after December 23, 2002. However, if you sold your home after May 6, 1997, and before December 24, 2002, you should consult with us to find out whether the new regulations affect your tax return(s). Because some aspects of the new regulations are different from previously issued IRS guidance, some individuals will be able to file amended returns and garner a tax refund.

### Mixed-use Property

If you maintain an office in your home or rent a room in the house, you are using your property for both residential and business purposes. The IRS now says there is no need to allocate your gain between business and residential use if the business use occurred within the same dwelling unit as the residential use. Thus, in this situation, you generally may apply the exclusion to your whole gain, without proration. However, you still must pay tax on the gain to the extent of total depreciation deductions you claimed after May 6, 1997, on the portion of the home used for business.

Note also that if the business use of your residence took place in a separate detached building on your property, you must treat your sale as two transactions for tax purposes. Gain allocable to the sale of the business portion of the property is taxable.



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## **Vacant Land**

The new regulations are favorable to homeowners who subdivide their property and sell their dwelling unit in one transaction and adjacent vacant land in another. In this situation, you may apply the exclusion (up to a total of \$250,000 or \$500,000) to the combined transactions, provided (1) you used the land as part of your principal residence, (2) the land sale occurs within two years before or after the sale of the residence, and (3) you otherwise meet the requirements for claiming the exclusion.

## **Reduced Maximum Exclusion**

The full \$250,000/\$500,000 gain exclusion is available for a sale of your principal residence only if you meet the tax law's timing, ownership, and use requirements. What happens if you don't? Is there any tax break available for your sale? Possibly, if the primary reason for your sale was an "unforeseen circumstance" or a change in health or place of employment affecting you or another qualified individual (your spouse, a co-owner of the home, or a member of your household). In such cases, you may be able to use a reduced maximum exclusion to shelter all or part of your gain from tax.

Unforeseen circumstances include:

- death;
- divorce or legal separation;
- becoming eligible for unemployment compensation;
- multiple births resulting from the same pregnancy;
- damage to the residence resulting from a natural or man-made disaster, or an act of war or terrorism; and,
- condemnation, seizure, or other involuntary conversion of the property.

To be eligible for a reduced maximum exclusion because of a change in place of employment, you or another qualified individual generally must have changed the *location* of your employment (or self-employment). The new work location must be at least 50 miles farther from the sold residence than the former workplace was. In the case of someone who was not previously employed or self-employed, the distance test is met if the new job or business location is at least 50 miles away from the sold residence.

The health condition test is met if the primary reason for the sale was to obtain, provide, or facilitate the diagnosis, cure, mitigation, or treatment of a qualified individual's disease, illness, or injury. Similarly, the test is met if the residence was sold in order to obtain medical or personal care for a qualified individual suffering from a disease, illness, or injury.

## **Have Questions?**

The new regulations contain numerous other details and examples. If you are planning to sell your residence — or have sold a residence recently — please don't hesitate to call on us for tax advice. We would be happy to assist you.

## **PROPOSED NEW TAX LAWS PERPLEXING AND EVER CHANGING**

*By Harvey McCown*

President Bush has proposed tax law changes that could be of great benefit to you. Politics have come into play (not to mention the possible war with its funding needs).

The President's proposals include:

1. Accelerate the tax rate cuts passed last year and make them effective 1/1/03. Democrats have proposed to freeze the tax rates at the 2002 level and not allow the additional cuts.
2. Provide 100% dividend exclusion at the individual level. Alternative proposals include a 50% exclusion, a \$3000-\$5000 exclusion, and even a deduction for the corporation for dividends paid.
3. Businesses can now expense \$25,000 of their equipment purchases if their total purchases for the year do not exceed \$200,000. The President proposes to increase those limits to \$75,000 and \$325,000.
4. Provide rules to permit donating IRAs to charities without suffering tax penalties.

The Democrats have responded with such suggestions as:

1. Provide a tax rebate of \$300 for a single person and \$600 to a married couple. This rebate would go to anyone with earned income and not just to those paying tax.
2. The current depreciation rules allow a 30% first year write off for new purchases (with a 20 year recovery period or less) during

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## **NOTARY SERVICES**

Did you know that Brown Armstrong offers Notary Services?

Ruth Lewis, from our Shafter office is now a notary.

In addition to Ruth providing service in our Shafter office, Madeline Parra, Melinda McDaniels and Tamara Acar provide notary services in the Bakersfield office.

# Staff News

## Welcome!



**Kim Sloan** will be graduating in June from CSUB with an accounting degree. Prior to his career in accounting, Kim spent almost ten years in the United States Airforce.



**Ryan Nielsen** is a recipient of a scholarship from Brown Armstrong and will graduate from CSUB in June. He is a member of the Active 20/30 club.



**Richard Gammel** is also a Brown Armstrong scholarship recipient and will graduate in June from CSUB with a degree in accounting.



**Victoria Nguyen** comes to us from the state of Maryland as a senior accountant. She has extensive background in business and tax strategies.



**Hanna Sheppard** is currently attending CSUB and will graduate in June with a major in accounting. She has a business background in the agricultural industry.



**Brian Letlow** is our new IT Director. He has a BS degree in Business Administration with a concentration in Management Information Systems and is Microsoft certified.

## *Congratulations!*



**Robert Clausen** passed all four parts of the CPA Exam. Good job!



Audit Manager, **Eric Xin and his wife, Pamela** gave birth to their first child. Christina was born on March 3, 2003 at 3:03 p.m.

Even the AFL-CIO has gotten into the picture proposing a 3.5% rebate on the first \$15,000 of a worker's earnings for 2002.

IRA revisions are on the table with new initials:

RSA – Retirements savings accounts to replace Roth IRA and increase the contribution limit to \$7,500 per year.

LSA – Lifetime savings accounts with an annual contribution limit of \$7,500 to be held for any reason.

And if that is not “clear” enough – consider California. The budget crisis has “everything on the table” when it comes to tax changes. Remember, the legislature can pass a tax bill as late as April 15, 2003 and make it retroactive to January 1, 2002! Can that happen? Congress did it last year when the tax bill became law on March 18, 2003 and was retroactive to September 11, 2002.

Enjoy your tax planning. We hope that whatever our government does turns out good for you and our country.

## **We're looking for your e-mail address...**

If you would like to receive the Newsletter and other important tax and audit updates by e-mail, please e-mail Deanna Blaise at **[dblaise@barrcpa.com](mailto:dblaise@barrcpa.com)** or Dawnee Harbach at **[dharbach@barrcpa.com](mailto:dharbach@barrcpa.com)**.

This newsletter as well as other important information can be viewed on our website at [www.barrcpa.com](http://www.barrcpa.com).