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Carr Talks

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WEEKLY SUMMARY

Well the country dodged the proverbial bullet on Friday when both parties blinked and passed an extension to the budget impasse that will allow the government to continue to pay its bills. What the agreement didn't address was the looming battle over the debt ceiling, and the budget for the next year.

For the first time serious discussions have started to be have about the 3 major areas of government spending, social security, Medicare and Defense.

Over the coming months, and leading up to the elections in November next year, you will hear more about the reduction in benefits, increases in taxes and redistribution of wealth. Of the $3.8 T budget, just under ½ comes from borrowed money.

There are two certain things a year from now. (1) Interest rates will be higher. Europe raised rates late last week and there is more talk about inflation while oil stays stubbornly over $110 a barrel and businesses are forced to pass on costs to a more financially challenged consumer. (2) Taxes are going up. Whether it is by reducing deductions, or eliminating credits, or just raising the rates and modifying the brackets, the amount that you pay in Federal taxes will be more 12 months from now.

For sure, it will be challenging.

Real estate losses become IRS Audit target

The repeal this week of the 1099 requirement for issuing documentation for all vendor payments over $600 is a positive move for those real estate owners buried with increasing costs, properties under water in value, higher property taxes, more licensing and regulations and the prospect of interest rates moving higher in the foreseeable future.

BUT the IRS is stepping up property scrutiny. Given that at least 53% of individual taxpayers with rental real estate activity for TY 2001 misreported their rental activity resulting in an estimated $21.4B of misreported income.

As of next week, if you filed on time, your 2007 and prior returns will be insulated from the 3 year statute.

Given that real estate is generally owned by higher bracket income owners, the IRS gets a bigger return at 35% adjustments than a 10% tax bracket.

It is likely that more information will be required for Sch E – number of days rented in the year and type of property. So the old phrase "same as last year" likely will not suffice for tax year starting in 2011.

In addition those taxpayers alleging to be real estate professionals, (working 50% of the time in real estate AND at least 750 hours a year in the business) are expected to have more scrutiny.

As income increases past $100,000, the losses from the rental activity are limited and not all the losses are able to be offset against other earned income. The limit of $25,000 in losses is phased out at $150,000 a year. While not able to be used in the current year, the losses are "suspended" and are carried forward into the next year.

For those thinking of getting into real estate, now may not be a better time. With property prices back to where they were a decade ago, with strong rental demand, lower values for property tax assessments, return on investment can easily eclipse 1% in a money market account.

Make sure you document all your out-of-pocket expenses, and especially mileage in managing your rental properties. Keep a diary to record all your trips and business mileage. Documentation!

Million Dollar - Whistle blower

Recently the IRS issued the first of what is expected to be a number of large checks to whistle blowers. The accountant for a financial services firm in 2007 "blew the whistle" on the firm. For 2 years he could not get any traction. He then hired a law firm to push the IRS. Recently he received, via regular mail no less, a check for $3,240,000. That represented his share of the bounty (less the 28% Federal withholding) of the $20,000,000 the financial services firm paid in penalties, interest and additional tax. His percentage 22% of the gross recovery. (Less of course the attorney's fees). The whistleblower office was created in 2007, has 17 employees but only promises rewards for recoveries of $2,000,000 or more.

Most referrals in the "tip and fraud" line come from ex spouses, ex employees, and competitors. They are not required to pay out rewards on these cases.

This new tool is seen as an additional way to "encourage" voluntary compliance and when combined with increasing audit levels for higher income levels, the pressure is on to limit the corner cutting.

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	Last Week	End of Week	Next Week	12/31/2011
Gold	$1,429.20	$1,476.40	$1,480.00	$1,600.00
Oil	$108.31	$113.05	$115.00	$120.00
Dow Jones	12,376.72	12,380.05	12,400.00	12,250.00
Prime Rate	3.25 %	3.25 %	3.25 %	4.00 %
Unemployment	8.80 %	8.80 %	8.80 %	9.50 %

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Comments, suggestions, and feedback welcome at john@carrtalks.com