

TAX AND BUSINESS *Alert*™

May 2012

We continually hear and read reports on the escalating cost of higher education. However, two tax credits are available to provide some relief for taxpayers who are paying these education costs for themselves or family members. The American Opportunity Tax Credit and Lifetime Learning Credit are available in 2012 to help students and parents cover the cost of higher education. Taxpayers will generally use the American Opportunity Tax Credit, as opposed to the Lifetime Learning Credit, since it will yield a greater monetary benefit.

The American Opportunity Tax Credit is a per student credit that may be claimed for each eligible student pursuing an undergraduate degree or other recognized education credential. The student must be enrolled at least half-time for one academic period to qualify for the credit.

The maximum American Opportunity Tax Credit is \$2,500 per student in 2012 based on 100% of the first \$2,000 and 25% of the next \$2,000 of the qualified tuition and related expenses paid during the tax year for education furnished to an eligible student. Qualified expenses include tuition and fees and course-

Education Tax Credits

related books, supplies, and equipment. Forty percent of the credit is refundable, which means that you may be able to receive up to \$1,000 even if you owe no taxes. This credit does phase out, but is generally available to eligible taxpayers whose modified adjusted gross income is less than \$80,000, or \$160,000 for married couples filing a joint return.



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Unlike the American Opportunity Tax Credit, the Lifetime Learning Credit is a per taxpayer (per return) credit, rather than a per student credit. It is available for all years of postsecondary education, including graduate level degree work, and for courses to acquire or improve job skills (e.g., work-related community college courses). The student does not have to be pursuing a degree or other recognized education credential to obtain the credit.

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The information contained in this newsletter was not intended or written to be used and cannot be used for the purpose of (1) avoiding tax-related penalties prescribed by the Internal Revenue Code or (2) promoting or marketing any tax-related matter addressed herein.


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IRS's Information on Exempt Charitable Organizations

The IRS recently launched a new online search tool entitled "Exempt Organizations Select Check." This search tool can be found at www.irs.gov/charities/article/0,,id=249767,00.html and allows users to search for:



1. Organizations eligible to receive tax-deductible contributions.
2. Organizations whose federal tax exemption has been automatically revoked for not filing a Form 990-series return for three consecutive years.
3. Form 990-N (*e-postcard*) filers that are small charities whose annual gross receipts are normally \$50,000 or less.


A search for eligible organizations may now be done by Employer Identification Number (EIN). The Auto-Revocation List (#2) may be searched by EIN, name, city, state, ZIP code, country, and revocation posting date. Information is updated monthly. 

Education Tax Credits

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For 2012, the maximum Lifetime Learning Credit allowed is \$2,000 (20% of up to \$10,000 of the aggregate qualified tuition and related expenses paid during the tax year for education furnished to an eligible student during any academic period). Qualified expenses include tuition and fees and course-related books, supplies, and equipment, but only if required by the eligible education institution for enrollment. The maximum credit is limited to the tax you must pay on your return—the credit is

nonrefundable. (Special rules apply for AMT.) This credit does phase out, but the full credit is generally available to eligible taxpayers whose modified adjusted gross income is less than \$52,000, or \$104,000 for married couples filing a joint return in 2012.

Although several of the rules and requirements are the same for both education credits, taxpayers can elect to claim only one of these credits for the same student in a tax year. However, this does not prevent a taxpayer from claiming a different credit (or the same credit) for different students in the same tax year. 

Excluding a Residence Sale Gain Following Divorce


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while such taxpayer's spouse or former spouse is granted use of the property under a divorce or separation agreement.

Example: Meeting the use test for delayed sale pursuant to divorce.

Randy and Ann have jointly owned their residence for seven years. They divorce and Ann moves into an apartment. The decree states that Randy can live in their jointly-owned house until it is sold, and he does

so. Four years later, the house is sold at a gain of \$300,000 and the proceeds are split between Randy and Ann pursuant to the divorce decree. Each former spouse can exclude their \$150,000 share of the gain. In meeting the use test, Ann is considered to be using the house as her principal residence during the time Randy resides there. Randy meets the use test because he actually lives in the residence.

Tax planning is an important aspect of dealing with a divorce. Please contact us to discuss the tax issues associated with a divorce or any other tax compliance or planning matter. 

A residence is often a married couple's most significant asset. As a result, monetary and tax considerations for property settlements related to the marital residence are usually extremely important to divorcing taxpayers. Specifically, to qualify for the exclusion of up to \$250,000 of gain on the sale of the residence, a spouse must satisfy both of the two-out-of-five years ownership and use tests. In addition, the tax consequences associated with a future residence sale are often considered when valuing the home for purposes of dividing assets. In a typical divorce, one spouse moves out of the residence and divorce proceedings, which may take several months to several years to complete, commence. In dividing up the marital estate, the marital residence is usually disposed of in one of three ways.

Residence Sold as Part of Divorce Proceedings. The divorce agreement may specify that the residence must be sold as part of the divorce process so the proceeds can be split between the spouses. If they independently meet the ownership and use requirements, each spouse's share of the gain can be sheltered up to \$250,000. The fact that each spouse files a separate return or they each file as single persons for the year of sale does not make a difference.

Example: Immediate sale of residence after divorce.

Jane and Mike Jones were divorced in January. In April, they sell the home they owned jointly and used as a principal residence for 15 years. The home is sold for \$800,000, resulting in a gain of \$400,000. They both meet the two-out-of-five year ownership and use tests. Therefore, each of them can exclude their \$200,000 share of the gain.

Ownership Transferred Incident to Divorce.

If the transfer of ownership of the principal residence from one spouse to the other is made during marriage or in a divorce, neither spouse recognizes gain or loss on the transfer. The receiving spouse's basis in the residence is the combined basis of both spouses before the

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transfer. If a taxpayer transfers a residence to a spouse or former spouse incident to a divorce, the transferee's period of ownership includes the transferor's ownership period, making that spouse eligible to exclude the sale gain.



Example: Exclusion of gain after transfer to spouse incident to divorce.

For 25 years, Tim and Fran James used a home owned by Tim as their principal residence. They divorce and pursuant to their divorce decree, Tim transfers ownership of the home to Fran. Six months later Fran sells the home at a \$200,000 gain. She can exclude the gain because she meets the two-out-of-five years use test, and also meets the two-out-of-five years ownership test because she can include Tim's ownership period as though it was her own.

Delayed Sale of Residence under Divorce

Agreement. For divorcing couples with children, it is fairly common for one spouse to move out and the other to reside in and maintain the home for the children. After the children complete school or otherwise move away from home, the home is often sold and the proceeds divided between the now-divorced spouses.

For purposes of the gain exclusion rules, a spouse who continues to own all or part of the marital residence, but no longer resides there (i.e., the nonresident spouse), is considered to be using the residence as a principal residence

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Reporting Barter Transactions

Bartering is one of the most ancient forms of commerce and involves the trading of a service or product for another. While our ancestors may have traded corn for eggs, today we might barter an auto repair for lawn service. Another example would be



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trading home improvement work for dental services. Typically, no cash is exchanged in the transaction, and business owners can save cash by bartering to get the products and services they need. In any case, the fair market value of the goods and services exchanged must be reported as taxable income by both parties.


Bartering may be done informally on a one-on-one basis between individuals or businesses, or it can take place on a third-party basis through a *barter exchange company*. Barter exchange companies increase the scope and customer base for anyone wishing to barter goods and services from one company to another within the membership base. Income from bartering is taxable in the year the exchange is made, and taxpayers may be liable for income, self-employment,

and excise taxes. Barter transactions can result in ordinary business income, capital gains and losses, or nondeductible personal losses.

Barter or trade dollars from a barter exchange company are identical to real dollars for tax reporting. If taxpayers barter products or services through a barter exchange, they should receive Form 1099-B (Proceeds from Broker and Barter Exchange Transactions) showing their barter transaction proceeds, which are generally reportable as income on their tax return. If taxpayers directly barter a product or service for another's product or service, they will have to report the fair market value of the products or services received on their tax return.

Example: Barter transaction.

Alex, a painting contractor, requires legal representation for a lawsuit. He engages Alice as legal counsel to represent him during the litigation. Alice charges Alex \$5,000 for her work on the case. Being short of cash, Alex agrees to paint Alice's office building in exchange for her \$5,000 fee. Both Alex and Alice must report \$5,000 of taxable gross income during the year the exchange took place. Since Alex and Alice each operate a viable business, they are entitled to deduct any business expenses resulting from the barter transaction.

In summary, taxpayers should treat barter income as they would any other income, report any taxable transactions, and keep accurate records to support those transactions. 

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May 2012