

# Client Bulletin

BUSINESS & TAX PLANNING IDEAS *for OUR CLIENTS and FRIENDS*

## Helping Families With Housing— and With Banking

In May, President Obama signed into law the Helping Families Save Their Homes Act of 2009. As its name suggests, this law includes several provisions to help distressed homeowners.

### Loan modifications and short sales

Homeowners with financial woes often ask lenders to modify their mortgage loans. A modification is a permanent change that results in a lower interest rate, a maturity date extension, a change from an adjustable to a fixed interest rate, a reduction of principal, or some combination of these features. Alternatively, troubled homeowners may request a lender's permission for a short sale. That's a transaction in which the house is sold and the lender receives less than the outstanding mortgage balance.

Under the new law, mortgage companies must modify existing loans or approve short sales in specific situations. In essence, the requirement takes effect if a foreclosure is likely and the mortgage company would recover less from a foreclosure than it would from a loan modification or short sale. This provision applies only when the borrower occupies the home as a principal residence.

### A better law for homeowners

In 2008, Congress passed a law that included a HOPE for Homeowners program. Under this program, lenders would replace existing mortgages with new 30-year, fixed-rate loans for 90% of a home's appraised value in order

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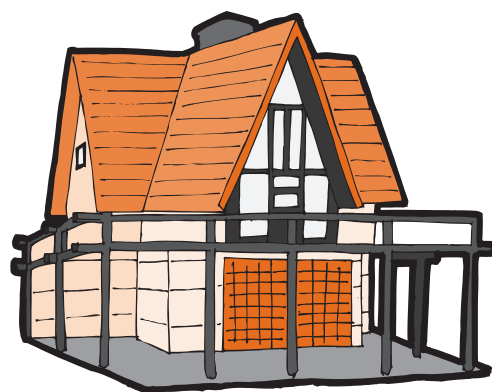
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### Did You Know?

**Over 55,000 businesses received angel funding in 2008, for a total of \$19.2 billion. The number of entrepreneurial ventures receiving funding was down only 2.9% from 2007, but the amount invested decreased by 26.2%. Thus, angels are committing fewer dollars per deal as a result of lower valuations and a more cautious approach to investing.**

*Source: Center For Venture Research at the University of New Hampshire*



to avoid a larger loss in a foreclosure. The program resulted in very few refinanced mortgages because it had intimidating red tape and eligibility requirements. Under the new law, mortgage companies will receive more compensation from the federal government for completed transactions, and homeowners will incur lower costs.

### Tenant protection

In some cases, lenders who have foreclosed on rental properties have evicted tenants even though they have been meeting their obligations. Now, lenders who foreclose on rental properties must allow tenants to occupy the property until the end of the lease term. If a buyer purchases a rental property and intends to occupy the home as his or her primary residence, the new owner must give the tenant at least 90 days notice before forcing the tenant to leave.

### Borrower notification

Many home mortgage lenders sell their loans to investors, who may resell those loans. The



America Counts on CPAs

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recently passed law requires the new mortgage owner to notify the borrower within 30 days after the sale of a mortgage on a primary residence. That's true even if the company servicing the mortgage remains the same.

### Federal deposit insurance

Federal laws often cover a lot of ground. The new Helping Families Save Their Homes Act also includes an extension of expanded insurance for bank accounts. Last year, Congress passed a

law that expanded federal insurance from \$100,000 per depositor per bank to \$250,000. That "temporary" extension was scheduled to last through 2009; the new law continues the expanded insurance coverage through 2013.

## Estate Planning for Bank Accounts

As mentioned above, federal deposit insurance is now up to \$250,000 per depositor per bank, at least through 2013. That ceiling may be extended to future years and may even be increased.

You can get even more federal deposit insurance if you know the rules. For example, individual depositors can get more coverage by setting up jointly-owned accounts as well. You can also get an additional \$250,000 of deposit insurance for retirement accounts such as IRAs.

Yet another tactic is to set up one or more trust accounts. Not only will you be entitled to more federal deposit insurance, you will create an efficient plan for transferring bank accounts to beneficiaries after your death.

### Inexpensive insurance

The rules for federal insurance of trust accounts often apply to revocable trusts, which can be cancelled by the trust creator. Some types of revocable trusts (sometimes known as living trusts) are created by attorneys. These revocable trusts may hold various types of assets. The revocable trusts used to hold bank accounts are less formal. You don't need to pay an attorney to create these trusts, which may be known as "Totten trusts," "payable on death" accounts, or "in trust for" accounts. Instead, you simply sign an agreement on the bank's signature card when you open a bank account.

### Copious coverage

The same \$250,000 limit for federal deposit insurance applies to trust accounts. However, the insurance coverage is per beneficiary; the account owner is excluded.

**Example #1:** Larry Harrison invests \$1 million in a Certificate of Deposit (CD) at a local bank. He signs a trust agreement and names his three children as the beneficiaries.

If the bank fails and no other bank assumes the deposits, the Federal Deposit Insurance Corporation (FDIC) will provide \$750,000 worth of insurance: \$250,000 times three beneficiaries. The excess \$250,000 won't be insured.

Even though the coverage is based on the number of beneficiaries, any FDIC insurance payment would go to Larry, the account owner, rather than his children.

**Example #2:** Assume Larry Harrison has no other accounts at that bank. If he wants to keep the account at that bank and have the same three beneficiaries, he could get full insurance by limiting the trust account to \$750,000. Larry could get insurance on a \$1 million trust account by naming a fourth beneficiary. Alternatively, Larry could put \$750,000 into a trust account with three beneficiaries and put the other \$250,000 into an account at the same bank under his own name, covered by his own \$250,000 of federal deposit insurance.

The maximum coverage for trust accounts with up to 5 beneficiaries is \$1.25 million—as much as \$250,000 per beneficiary for 5 beneficiaries. You can obtain more coverage by adding beneficiaries or using a co-owner.

**Example #3:** Larry Harrison and his wife Kara invest \$2 million in a CD. They create a trust account to hold the CD and name their three children and a niece as beneficiaries. With two owners and four beneficiaries, they are entitled to eight times the \$250,000 coverage limit: two owners times four beneficiaries. Thus, the entire \$2 million account would have federal deposit insurance.

### Estate planning effects

When you set up a bank trust account, the money in the account is not covered



by your will. If you die while holding the account, the money will go to the beneficiaries you've named. Your beneficiaries won't have to endure the time and expense of going through probate.

Meanwhile, you will control those bank accounts as long as you're alive. You can withdraw money and spend it (subject to any deposit terms that penalize withdrawals before a cer-

tain date). Neither the beneficiaries nor their creditors will have access to the account. You can change beneficiaries or cancel the trust account agreement.

There is a drawback, however. Any money in a trust account goes to the beneficiaries you've named, and not to anyone else. In the preceding example, Larry and Kara Harrison name their niece

as a beneficiary along with their three children. If Larry and Kara die in an auto accident, 25% of that account will go to the niece, even if the Harrisons' wills call for their assets to go only to their three children. Therefore, you should use a bank trust account only if you're certain you want the named beneficiaries to inherit the account.

## Past Mutual Fund Losses Can Shelter Future Gains

During 2008, a disastrous year for many investors, virtually all stock mutual funds posted large losses. Those losses, although painful, can provide mutual fund investors a crucial tax benefit. To take advantage of this tax break, you should understand how mutual fund taxes work.

**Example #1:** Shareholders of stock fund ABC own a total of one million shares. During a given year, ABC buys and sells various stocks in hopes of increasing returns and to generate cash for investors who redeem shares of the fund. As ABC reaches the end of its tax year, it finds that its trades for the year have resulted in net gains of \$10 million. In order to avoid owing taxes itself, ABC makes a \$10-per-share capital gains distribution to its shareholders.

For those shareholders who hold ABC in a taxable account, these distributions are taxable events. If Heather Gray owns 100 shares of ABC, she will report \$1,000 of capital gains on her tax return and owe income tax on those gains. She will owe this tax regardless of whether she pockets the \$1,000 distribution or chooses to reinvest it in more ABC shares.

### Tax-free gains

In 2008 many mutual funds incurred more losses than gains on their stock trades (the same may be true in 2009). Unlike gains, funds can't pass through those losses to shareholders.

**Example #2:** Stock fund XYZ also has one million shares in the hands of investors. As XYZ reaches the end of its tax year, it determines that its trades for the year have resulted in \$10 million of net losses. Therefore, XYZ makes no capital gains distributions for the year. XYZ does not distribute its losses either. Instead, it carries a \$10 million "capital loss carryforward" on its books.

Such losses can carry forward to as many as eight future years. Suppose that XYZ has \$7 million in realized capital gains in 2009. The fund's \$10 million loss carryforward would completely offset the \$7 million gain, so shareholders would owe no tax for that year. The other \$3 million net loss would carry forward for up to seven more years, to offset tax on up to \$3 million of realized gains by XYZ.

The bottom line is that mutual fund losses from the current bear market can shelter future mutual fund gains for several years. However, this tax shelter applies only to investors who buy mutual funds and continue to hold them. As long as you hold onto mutual fund shares, you don't have to report any gains. When you sell mutual fund shares in a taxable account, however, you have to report a gain or loss. For example, if you buy XYZ at \$12 a share in 2009 and sell for \$18 a share in 2010, you'd have to report a gain of \$6 a share, even if XYZ still has loss carryforwards.

### Realized or unrealized?

Mutual fund losses fall into two categories:

- 1. Realized losses.** If fund XYZ lost \$10 million in trades last year, those losses are locked in. Investors know that they'll be able to offset \$10 million of future gains realized by XYZ and owe no income tax.
- 2. Unrealized losses.** Suppose XYZ holds stocks currently valued at \$20 million. XYZ bought those stocks for \$32 million. Therefore, XYZ has unrealized losses of \$12 million.

Some observers will combine the two numbers and say that XYZ's potential capital losses total \$22 million: \$10 million realized plus \$12 million unrealized. Is this viewpoint valid?

There are two schools of thought on this issue. Some people say that a realized, locked-in capital loss is the only one to count. You know you have \$10 million of tax shelter in the XYZ example. On the other hand, depending on how the stock market does today, that \$12 million unrealized loss could be an \$11 million unrealized loss or a \$13 million unrealized loss tomorrow. There's no knowing if those unrealized losses will ever be realized and offset future gains.

Others insist that an unrealized loss has value, too. If you invest when XYZ has an unrealized loss of \$12 million, you probably will not see taxable capital gains distributions for several years. When XYZ makes a trade, going

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forward, that trade is far more likely to result in a taxable loss than a taxable gain.

As an investor, you might want to consider both realized and unrealized losses but give greater weight to realized losses. In any case, the magnitude of the losses is less important than the ratio of losses to the fund's assets. If XYZ has \$10 million of realized losses and \$20 million of assets (50%), it probably will offer a longer holiday from tax than a fund with \$10 million of realized losses and \$100 million of assets (10%).

**Evaluate the dog, not the tail**

Both realized and unrealized losses can be hard to discover from a mutual fund's financial statements. Our office can help you determine the capital loss position of a particular fund.

However, you should not forget the traditional advice: Don't let the tax tail wag the investment dog. When you're deciding whether to buy

or hold onto a mutual fund, your key concerns may include the fund's investment philosophy, the manager's performance record, and its expenses. Nevertheless, capital loss carryforwards can be important, too, especially if you're choosing between funds that are otherwise equally appealing.



## Tax Calendar

### SEPTEMBER 2009

**September 15**

**Individuals.** If you are not paying your 2009 income tax through withholding (or will not pay in enough during the year tax that way), pay the third installment of your 2009 estimated tax. Use Form 1040-ES.

**Employers.** For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in August if the monthly rule applies.

**Corporations.** File a 2008 calendar year income tax return (Form 1120 or 1120-A) and pay any tax, interest, and penalties due. This due date applies only if you timely requested an automatic six-month extension.

Deposit the third installment of estimated income tax for 2009. Use the worksheet Form 1120-W to help estimate tax for the year.

**S corporations.** File a 2008 calendar year income tax return (Form 1120S) and pay any tax due. This due date applies only if you timely requested an automatic six-month extension. Provide each shareholder with a copy of Schedule K-1 (Form 1120S) or a substitute Schedule K-1.

**Partnerships.** If you were given an additional five-month extension, file a 2008 calendar year return (Form 1065). Provide each partner with a copy of Schedule K-1 (Form 1065) or a substitute K-1.

### OCTOBER 2009

**October 15**

**Individuals.** If you have an automatic six-month extension to file your income tax return for 2008, file Form 1040, 1040A, or 1040EZ and pay any tax, interest, or penalty due.

**Employers.** For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in September if the monthly rule applies.

**Electing large partnerships.** If you were given an additional six-month extension, file a 2008 calendar year return (Form 1065).

In accordance with IRS Circular 230, this newsletter is not to be considered a "covered opinion" or other written tax advice and should not be relied upon for IRS audit, tax dispute, or any other purpose.

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