



**SPECIAL POINTS  
OF INTEREST:**

- **Audits of Individuals Have Increased 77 Percent.**
- **How to Qualify Your Home Office**
- **The Top Ten Things You Need To Know About Keeping What You've Earned.**
- **Looking for Someone You Can Rely On?**

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**by Mark Fox**

# Taxing Times

*Dedicated to helping our clients keep the money that belongs to them through a focus on tax.*

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## Rental Property and the Tax Gap

Not reporting or under reporting rental income contributes to the tax gap. Landlords need to be aware of everything that counts as income and what expenses are deductible.

### What is the Tax Gap?

In its simplest terms the Tax Gap is the difference between what the Internal Revenue Service estimates it should collect and what it actually collects in a given tax year through voluntary compliance. In 2005, the IRS estimated this tax gap to be approximately \$345 billion. Individual income tax accounts for over 71 percent of the tax gap, due in large part to the fact that individual income tax is the largest source of federal receipts. It is also estimated that rental and royalty income is being underreported by over 51 percent. These estimates, which remain the most recent estimates available, were compiled using data collected in tax year 2001 and before.

As a direct result of the IRS' mandate to close

the Tax Gap, audits of individual income tax returns increased by 77 percent between 2001 and 2006, when they conducted nearly 1.3 million audits.

### What Do I Have to Include as Rental Income?

In the simplest terms, rental income is any payment received for the use or occupation of property. In addition to normal rental income there are other forms of income that may need to be included in your rental income.

An advance rental payment is one you receive before the period it covers. For example, you sign a 10-year lease to rent your property.

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*Good records are the best defense in the event of an audit. You must be able to document your income and expenses.*

## COMMONLY MISSED BUSINESS DEDUCTIONS

Many business taxpayers overlook legitimate business deductions, resulting in an overstatement of their tax liability. Some of the more commonly missed deductions include business expenses paid out of personal funds, expenses related to a home office, and the use of personal telecommunication devices for business purposes.

*A trade or business expense is deductible only if it is ordinary, necessary and reasonable for your business.*



### General Business Expenses

Generally, a deduction is allowed for all

ordinary and necessary expenses paid or incurred during the tax year in carrying on any trade or business. Business owners who use their personal funds for business expenses such as office supplies often fail to deduct this as a qualifying expense.

A trade or business expense is deductible as such only if it is

*Continued on page 2*

## Hire Local and Reduce Your Taxes!

Can hiring someone save you taxes? If you have recently hired a Mobile native then your answer is probably yes!

How you ask? There have been various Work Opportunity Tax Credits available for a number of years but these credits have been difficult to put into practice until the passage of the American Recovery Act of 2009. This is because the credits are designed to hire people in a number of “target groups” who are typically hard to employ and employers were required to obtain state certification before becoming eligible for the credits.

There are many target groups but the one that will most likely benefit your business is the Hurricane Katrina target group. These are employees that you have hired for the first time before August 28, 2009 and their principal residence

was in Mobile or Baldwin County (or other areas impacted by Hurricane Katrina) on August 28, 2005. In addition, there is no pre-certification required to be eligible for this particular credit. The credit can be as much as \$2,400 per employee and is a direct reduction of your potential tax liability. Some other target groups that may benefit your business are:

- Unemployed Veteran
- Disconnected Youth
- Designated Community Resident
- Summer Youth Employees



*Don't leave money on the table. If you've hired someone, you may be eligible for a tax credit.*

## COMMONLY MISSED BUSINESS DEDUCTIONS *(continued from page 1)*

“ordinary and necessary.” An “ordinary” expense is generally one that is normal, customary or usual for a business under the facts and circumstances of the situation. A “necessary” expense is one that is appropriate and helpful for the trade or business. A final requirement is that the expense must be reasonable.

One of the more commonly overlooked general business expenses is the business use of personal telephones, cellular telephones and internet connections. If you carefully document how much these devices are used for personal and business use, the business portion may be deductible.

### Home Office Deductions

If you use part of your home as a home office, you may be entitled to deduct expenses related to your home office based on the percentage of square footage the home office occupies. Related expenses include mortgage interest, property taxes, utilities, and insurance and repairs.

To qualify for the deduction, the portion of the home that is used for the home office must be used exclusively and on a

regular basis as your principal place of business. To be your principal place of business your home office should be the place where, in the normal course of business, you meet with patients, clients, or customers. There are exceptions to the exclusive use rule for storage use and for day care services.



*Entertainment expenses related to your business are deductible—even if you pay for them yourself.*

### Meals and Entertainment Expenses

Business owners will frequently use their personal funds to pay for meals and entertainment expenses. These expenses qualify as a business deduction, subject to certain limitations. To be deductible as business expenses, entertainment expenses must have a proximate relation to your trade or business and be reasonably expected to benefit the trade or business.

Deductions for business meal expenses

are subject to the same business – connection requirement as entertainment expenses. However, the deduction will be denied if the meals are lavish or extravagant or if you or an employee are not present when the food or beverage is served. A deduction is allowable when the customer’s spouse, your spouse or both are present at the meals, provided the general conditions for deductibility are otherwise present.

The cost of entertaining business associates and customers at home is also deductible. However, in the case of business meal entertaining at home, you must be able to clearly show that the expenditure was commercially rather than socially motivated.

### Substantiation

Regardless of the type of cost you are trying to deduct as a business expense, you must be able to substantiate each expense and how it relates to your trade or business. The importance of keeping appropriate records cannot be overemphasized. If you’d like assistance in making sure you are allowed every deduction you’re entitled to, call our office for an appointment today. ☎

**Looking for someone you can rely on?**

As CPA’s we work with a lot of great, local businesses. Many of them we get to know quite well and feel comfortable in their ability to deliver the goods and/or services they promise. Below you’ll find a list of some of the businesses we feel confident enough in to refer to you. Should you have the need for their products or services, give me a call and I’ll introduce you.

- ◇ Bathroom Remodeler
- ◇ Home Builder
- ◇ Plumber
- ◇ Photographer
- ◇ Veterinarian
- ◇ Air Conditioning
- ◇ Printer
- ◇ Termite and Pest Control
- ◇ Wedding Cakes
- ◇ Chiropractor
- ◇ Pressure Cleaning Service
- ◇ Window Cleaning
- ◇ Copier Sales and Service
- ◇ Massage Therapist
- ◇ Auto/Home/Life Insurance
- ◇ Building Materials and Supplies
- ◇ Medicare Advantage Plan
- ◇ Realtor
- ◇ Mortgage Reduction Software
- ◇ Financial Advisor
- ◇ Advertising Specialties
- ◇ Mary Kay Cosmetics
- ◇ Mortgage Broker
- ◇ Self Storage Facility

**CLIENT COMMENTS**

*Thanks for all you do! -  
Fred & Daphne L.*

*I rarely call, but when I do, Richard is available quickly. I appreciate that very much! - Joanne L.*

*Everyone has always been courteous and pleasant to work with—We appreciate that greatly.—Shelley & Julius P.*



*Our returns are always completed quickly.—Bradley & Sherry G.*

*Good service.  
Good value.—  
Erin W.*

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*You take care of everything.—Liz W.*

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## Zevac & Lindsey Beer Tasting

On the evening of August 27, 2009, we had a great seminar given by Richard Lindsey, Darrell Manning, and Ted Greenspan about “How To Go Beyond Hanging On To What You’ve Earned,” followed by a beer tasting and hors d’oeuvres at Banana Docks Café.

Richard Lindsey discussed, “The Top Six Things You Need To Know About Keeping What You’ve Earned; Sure-fire approaches to take and serious pit falls to avoid.” Some of these topics included putting assets in a trust, the Medicaid five year look-back, reverse mortgages, and using life insurance to foot the estate tax bill. The complete whitepaper *The Top Ten Things You Need To Know About Keeping What You’ve Earned* can be found in the newsletter section of our website, [www.ZevacLindsey.com](http://www.ZevacLindsey.com).

Darrell Manning, financial advisor, and Ted Greenspan, Attorney



From left to right:  
Ted Greenspan, Darrell Manning and Richard Lindsey

at Law, emphasized the importance of investing for retirement, trust funds, and establishing a will that best suits your family’s situation. Everyone gave informative speeches with wonderful examples.

After the enlightening seminar, the beer tasting and hors d’oeuvres began. Before each of the four beers was served, a brief description of the beer was given including the name, a brief history, the flavors to look for, and the alcohol percentage. Each beer was accompanied with a delicious hors d’oeuvre prepared by Banana Docks Café. The night was filled with gaining great knowledge and tips from the seminar while enjoying great conversations with clients and friends. ❁



Clients enjoying the beer tasting and hors d’oeuvres.

One of the major roadblocks to creative thinking is assuming that there’s only one right answer

to any problem or opportunity that you’re having, and we all know that there’s probably hundreds, or even thousands, of ideas or solutions that would be better than the first one that you come up with.

But, one of the major problems most people have is, when they’re looking for a creative solution, they stop when they get the first idea that has any merit at all. A better idea is to come up with a lot of ideas first, even hundreds of ideas, before you actually pick one, because the best way to get a great idea is to get a lot of ideas to choose from.

I had this guy, a student in my class once, ask, “Now, why would I waste my time coming up with a whole bunch of answers if I’ve already got a solution that will work?”

I explained it to him this way; I said, “If you were looking for a date, would you rather have three girls to pick from or three hundred?”

### *One Right Answer by Mark Fox*

Then the light bulb went off in his head. Well, girls, if you don’t like that example, switch it with guys, and if you don’t like that example, switch to your preference.

Or just think about buying a house or a car. What if you were in a new neighborhood looking for a home and there was only one house to choose from? Do you really think you’re going to get the best solution for your needs?

So the best way to get a good idea is to get a lot of ideas first.

This reminds me of a story in grade school—we had to build these homemade manometers in our garages. And what a manometer is it’s something that measures pressure. And this simple design, it’s just plastic tubing with some colored water in it. And, if you remember, the higher you go in altitude the less pressure you have, so you can use this manometer to measure altitude.

*Continued on back cover*

## Rental Property and the Tax Gap *(continued from page 1)*

When the lease is signed you receive \$5,000 for the first year's rent and \$5,000 as rent for the last year of the lease. You must include \$10,000 in your income in the first year.

Security deposits are considered advance rent if used as a final payment of rent and should be included in your income when received. However, if you plan to return the security deposit to your tenant at the end of the lease, do not include it in your income. But if you keep any part of the security deposit because your tenant does not live up to the terms of lease, include the amount you keep in your income in that year.

Payment for cancelling a lease occurs if your tenant pays you to cancel a lease. Report the payment as rental income in the year you receive it.

If your tenant pays any of your expenses, the amount must be included in rental income. You may also be able to deduct the expenses. For example, your tenant pays the property taxes and deducts that amount from the normal rent payment because the lease does not require them to pay it. Include the amount the tenant paid as rental income and deduct the property taxes as a rental expense.

Property or services received in lieu of money must be included in your rental income based on the fair market value of the property or services. For example, your tenant is a painter and you agree to let her paint your property in exchange for two months rent. Include in your rental income the amount the tenant would have paid for two months rent.

Lease with an option to buy payments are usually counted as rental income. If the tenant buys the property, payments received after the sale date are generally counted as part of the selling price.

### What Deductions Can I Take as Rental Expenses?

You can deduct the ordinary and necessary expenses for managing, conserving and maintaining your rental property. Ordinary expenses are those that are common and generally accepted in the business. Necessary expenses are those that are deemed appropriate, such as mortgage interest, property taxes, advertising, maintenance, utilities and insurance. This includes expenses incurred from the time the property is made available to rent and is actually rented.

The cost of repairs to your rental property is also deductible. This includes the cost of labor and materials. However, you cannot deduct the cost of your own labor. A repair keeps your property in good operating condition and does not materially add value to the property. Examples include painting, fixing leaks and replacing broken windows.

An improvement, such as a new deck or fence, is something that adds value to your property, prolongs its useful life, or adapts it to new uses. The cost of improvements cannot be deducted and must be recovered through depreciation.

### What Records Should I Keep?

Good records are the best defense in the event of an audit. You must be able to document your income and expenses. Good records will also help you prepare your tax return.

Keep track of any travel expenses, such as mileage, you incur for your rental properties. A mileage log detailing your trips for showing the property and for repairs is the best documentation for travel expenses. Separate your receipts for minor repairs from those for capital improvements.

You must be able to substantiate certain expenses in order to deduct them. Generally you must have documentary evidence, such as receipts and cancelled checks, to support your expenses.

In the event of an audit, items on your tax return that you cannot support will be disallowed by the IRS and you may be subject to additional tax, penalties and interest. Good records will support the income and expenses on your tax return and help you avoid costly errors. ❁



*Landlords need to be aware of everything that counts as income and what expenses are deductible.*

# ZEVAC & LINDSEY

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## *One Right Answer by Mark Fox (continued from page 4)*

Well, as part of the class, we had to do these stand up presentations to discuss this thing we'd just built and answer questions from the teacher. Now, the teacher asked this one student, "How would you use your manometer to measure the height of the building across the street?"

Of course, the answer the teacher was looking for is, for the student to go measure the pressure, the atmospheric pressure at the bottom of the building, then measure at the top of the building, and use the pressure differential to calculate the height of the building.

The student said, "Ok, I know how I can measure it. I'm gonna just go to the stairwell of the building and take my manometer with me, and because I know it's twenty inches tall, I can just go and mark off twenty inch sections and count them all the way up to the top of the building."

The teacher said, "No, that's not really the answer I was looking for—how else can you use your manometer to measure the height of the building?"

"Well, I guess I could tie a string to my manometer and go to the top of the building and just lower the manometer all the way to the ground until it touches then pull the string back up and see how long it is."

"Ok, why don't you try again?"

"I remember from my physics class the equation for a falling ob-

ject is...let's see...one-half times gravity times time squared, so I guess I can just throw the manometer off the roof and time how long it takes to smash on the ground and then solve the equation for the height of the building."

"Alright, how about if I take it and stand it vertically next to the building, and I know it's twenty inches tall—I can measure the length of its shadow and then measure the length of the building's shadow, and ratio the two. That way I can find out how tall the building is."

The teacher said, "You're driving me crazy."

At this point, the teacher's steaming. "Knock it off! You know exactly what a manometer's supposed to be used for. What's the simplest and easiest way to use that manometer to measure the height of the building?"

Ok, the simplest and easiest way to use this manometer to figure out how tall this building is would be just to walk into the superintendent's office and say, "Hey, I built this really cool manometer. I'll give it to you if you tell me how tall the building is."

So, just remember, one big roadblock to creative thinking is assuming that there's only one right answer. The best way to get a great idea is to get a lot of ideas first. ❁

**Read more from Mark Fox at [www.slyasafox.com](http://www.slyasafox.com)**