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April 15, 2011

Dear Client and Colleague:

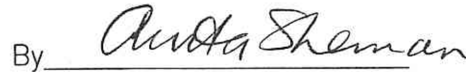
For the third year in a row, Greenwalt CPAs, Inc. employees have named Greenwalt CPAs as a Top Workplace Company. This year we were ranked first in three of the six categories, out of the 51 companies in the small company category (firms with 50 to 150 employees). This annual survey, sponsored by the Indianapolis Star, is conducted by an independent organization, and the results will be announced in the April 17, 2011 edition of the Star.

The survey covers six major categories, and Greenwalt CPAs ranked #1 in Execution, Direction and Conditions, and #2 in Career. We are appreciative that our team has again bestowed this honor on us, but we also firmly believe that in reality our clients are beneficiaries as well, and that is very important to us.

Enclosed is the May issue of our CPA Client Bulletin which contains important financial tips, options and reminders with respect to timing of interest income and recognition, donations of appreciated securities and investing options.

Very truly yours,

GREENWALT CPAs, INC.

By 
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Client Bulletin

Smart Tax, Business & Planning Ideas *from your* Trusted Business Advisor[sm]

May 2011

With Savings Bonds, Prepaying Tax May Be a Good Tactic

U.S. savings bonds can be good investments, especially if purchased for young children. They're issued by the federal government, so bond holders don't have to worry about a default. Yields are comparable to the yields on bank accounts. They're fairly liquid: owners can cash in savings bonds one year after the purchase and can redeem these bonds with no loss of interest after five years. (If you redeem savings bonds within five years, you'll lose the interest for the latest three months.)

Taxes, too

Owners of savings bonds also receive tax advantages. The interest is exempt from state and local income tax. Savings bonds are issued by the U.S. Treasury Department so they enjoy this tax treatment, along with all Treasury bills, notes, and bonds.

Moreover, individual owners of savings bonds can defer the tax on that interest as long as the bonds aren't cashed in.

Example: John Smith buys a $100 I Bond (an inflation-protected savings bond) as a birthday gift for his newborn niece, Kaylyn Jones. Buying online at www.treasurydirect.gov, he pays face value for a $100 bond.

Kaylyn puts away the bond until age 36, when she decides to cash it in. She redeems the bond then for $400, which represents an annualized return of around 4%. Kaylyn reports a $300 gain on the bond and owes tax at ordinary income rates. Because Kaylyn will be established in her career by then with a substantial income, she'll owe tax at a high rate. Although Kaylyn's actual tax bill is modest in this example, an individual taxpayer who cashes in a large amount of savings bonds in one year could owe a significant amount of tax.

An alternative approach

When a child owns a savings bond, the parents may prefer to pay the tax each year rather than defer the tax. In the

continued on page 2

What's Inside

1 With Savings Bonds, Prepaying Tax May Be a Good Tactic
2 Use Appreciated Assets for Charitable Donations
3 Going for the Gold
4 Tax Calendar

Winning the Numbers Game

If you buy a savings bond as a gift and don't know the recipient's Social Security number, you may use your own because the Social Security number printed on the bond does not establish tax liability or ownership.

continued from page 1

Trusted Advice

Tax-Free Savings Bonds

- The interest from savings bonds you cash in may be tax-free. That can be the case if you use the money for college tuition and fees.
- Several conditions apply. For example, you must have been at least age 24 when you bought the bonds.
- Either you or your spouse must own the savings bonds.
- The bond proceeds may be used for the owner's education, the owner's spouse's education, or the education of a dependent for whom the owner claims an income tax exemption.
- Income limits exist for this tax benefit. For completely tax-free income, your modified adjusted gross income (MAGI) in 2011 must be no more than $106,650 on a joint tax return or $71,100 on other returns. The tax exclusion is completely phased out with MAGI of $136,650 on joint returns and $86,100 on other returns. These numbers increase with inflation.

Kaylyn Jones example, the annual income might be around $4 or $5 a year while she is a youngster. As long as Kaylyn has little or no taxable income, the tax bill will be scant.

A parent can make this choice for a child at any time. To do so, you file a tax return for the child and report all the interest earned on the bonds from the date of their acquisition through year-end that has not previously been reported. You'd also state on the return that your child chooses to report the interest each year. Be sure to keep a copy of this return indefinitely. If your child is not required to file a tax return for any year after making this election, he or she does not have to file a return just to show the annual accrual of U.S. savings bond interest. Public Debt Form 3501, available at www.treasurydirect.gov, shows annual interest on savings bonds, which will help you keep track of interest accruals. You'll include the annual interest on the child's tax return in any year that he or she is required to file one.

This strategy is not necessarily limited to children who own savings bonds. A taxpayer who finds himself in a low tax bracket in a given year might choose to pay tax on accrued savings bond interest at that time if he expects to return to a higher bracket in the future. When you make such a payment, you're electing to pay tax each year on all savings bonds you own as well as any purchased in the future. You can, however, revoke this election and go back to deferring interest income by attaching a statement to a future tax return. ■

Use Appreciated Assets for Charitable Donations

Writing a check is the easiest way to make charitable contributions. However, donating appreciated assets can be more tax-efficient. That's true if the donated assets have been held longer than one year and, thus, would qualify for long-term capital gains tax treatment on a sale.

Example: Mark Parker wants to donate $5,000 to a local animal shelter. If he writes a check for $5,000, he'll get a $5,000 tax deduction. Mark's cost for this deduction is $5,000, after-tax.

Instead, Mark goes through his portfolio and finds a stock he bought in 2009 for $3,000 and, thus, would qualify for long-term capital gains treatment. That stock now sells for $5,000. Mark decides to donate the stock to the animal shelter. With this approach, Mark gives a donation of $5,000, the fair market value of the donated assets. However, those shares are really not worth $5,000 to Mark. To cash them in, he would owe tax on a $2,000 long-term capital gain. At a 15% tax rate, Mark would owe $300. Therefore, by donating the shares, Mark gets a $5,000 tax deduction by relinquishing an asset that would be worth only $4,700 to him, after-tax.

Did You Know?

States have set aside a total of $2.35 trillion to pay for employees' retirements, but the cost of those benefits is $3.35 trillion. That leaves a $1 trillion gap. Only four states have fully-funded pension systems: Florida, New York, Washington, and Wisconsin.

Source: Pew Center on the States

After the contribution, the animal shelter can sell the donated shares. As a charitable organization, the shelter owes no tax on the sale. Consequently, the charity gets the same $5,000 contribution with this strategy, and Mark is better off than he would have been writing a check.

To implement this strategy, you can call the charity and get its brokerage account number. Then call your own broker or mutual fund company and explain what you want to do and provide the charity's account number. If you wish to donate part of a position, specify the shares you wish to contribute. Follow up by sending an e-mail to your broker or fund company and eventually check with the charity to confirm the transaction.

Note: Different rules apply to contributions of tangible personal property, patents and other intellectual property, and property contributed to certain private foundations. In most cases, the deduction for a property in one of these categories will be limited to the property's fair market value less the long-term capital gain that would have been recognized if the property had been sold for fair market value at the time of contribution.

Spreading the wealth

The procedure described in the previous paragraph can work well if you are making one or two relatively large charitable contributions. However, if you plan to make $500 contributions to each of 20 charities, the process may get cumbersome. Instead, consider donating through a donor-advised fund (DAF).

Many financial firms and local community foundations offer a DAF. You make donations directly to the fund; the minimum initial contribution might be a lump sum donation of $10,000. You'd get a charitable deduction for the year the assets go into the DAF. If you donate appreciated assets held longer than one year, your deduction usually will be the assets' fair market value.

The DAF typically will create an account in your name after it has received your initial contribution. Then the DAF will sell the donated assets, owe no tax, and put the cash into your account. Subsequently, you can request the DAF to make "grants" to specified charities from your account. For multiple donations of appreciated securities, using a DAF will simplify the process. ■

Going for the Gold

In 2001, the price of gold was about $250 an ounce. Ten years later, as of this writing, gold trades at more than $1,400 per ounce. Therefore, investors who held gold during this time period generally prospered, especially compared with those who invested in the broad stock market. According to Morningstar, the average precious metals mutual fund had an annualized return of 25.26% for the 10 years through 2010, whereas the average domestic stock fund had an annualized return of only 2.77%.

Considering such recent results, should you allocate some of your portfolio to gold? Bulls contend that people all over the world prize gold as a way to hold wealth, and have done so for centuries. They also contend that gold is an effective hedge against inflation and geopolitical unrest.

Taking the opposite view, Bears point out that gold prices reached as high as $850 an ounce in 1980. In the next 21 years, as gold fell to $250, an investment in gold lost about 70% of its value. Today's investors have no guarantee against a similar slide.

You should discuss the pros and cons with your investment advisor. Such a discussion can help you decide whether to invest in gold and, if you favor the idea, how much of your portfolio to allocate there.

Various vehicles

Suppose you have a $300,000 investment portfolio, and you decide to invest 10% in gold. You have many options for investing that $30,000.

- **Gold mining stocks.** Many companies with gold mining operations are publicly-traded, so you can buy shares through a broker. With gold mining stocks, you have what some people call "operating leverage."

Example: Gold Mining Corp. ABC produces and distributes its gold at an average cost of $1,000 per ounce. If it sells the gold for $1,400, it makes a profit of $400 per ounce.

Now suppose gold prices climb to $1,500 an ounce. That $100 increase is about a 7% upward move. Assuming no change in ABC's production and distribution costs, its profit margin goes from $400 to $500 an ounce, an increase of 25%. The stock price of ABC might move with its profitability and, thus,

continued on page 4

continued from page 3

increase by more than the 7% move in the underlying gold price.

Thus, investing in gold mining stocks might deliver good results if gold prices increase. On the other hand, a 7% drop in the price of gold would cut ABC's profit margin by about 25% in our example, which could sink ABC's stock price.

- **Mutual funds.** Dozens of mutual funds exist that hold shares of mining companies. Because each of these funds own many companies, they may be less volatile than individual gold mining stocks. Some of these funds also own companies that mine silver and other metals. Diversifying can produce less risk for investors, even if it means less potential profit than you'd find in one stock or one type of mining company.
- **Exchange-traded funds (ETFs).** Some ETFs hold gold bullion rather than mining stocks. That is, an ETF that raises $1 billion with a public offering might buy $1 billion worth of gold bars and store that gold in one or more bank vaults. As the price of gold rises and falls, so will the value of the ETF's gold and probably the price of its shares. Thus, bullion-backed ETFs may closely track the price of gold.

As a result, bullion-backed ETFs may have less correlation to the stock market than mutual funds holding mining stocks. You may prefer these investments if your main concern is portfolio diversification. On the downside, metals (including gold) are considered to be collectibles, in the eyes of the IRS. Therefore, long-term capital gains on bullion-backed ETFs generally will be taxed at a maximum rate of 28%. That's true even though investors don't physically hold the gold. Under current law, long-term gains on stocks and stock funds are taxed no higher than 15%.

Other gold ETFs hold gold futures contracts, where the tax treatment can be even more complicated.

- **Coins and bars.** Yet another alternative is to buy gold coins and gold bars. You can hold collectible coins, which may merit higher prices for their rarity and their condition; alternatively, you can buy specially-issued bullion coins, such as American Eagles, that trade solely on their gold value.

With coins and bars, you get to physically hold your gold. In case you need or want to sell, you merely have to go to a local dealer to raise cash. However, owning gold coins and bars adds storage and insurance issues. Some dealers will take significant markups on purchases and sales.

What's more, you'll face tax issues with coins and bars. Profitable sales of gold coins and bars held longer than one year will be taxed up to 28% as collectibles. ■

TAX CALENDAR

MAY 2011

May 10

Employers. For Social Security, Medicare, and withheld income tax, file Form 941 for the first quarter of 2011. This due date applies only if you deposited the tax for the quarter in full and on time.

May 16

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

JUNE 2011

June 15

Individuals. If you are not paying your 2011 income tax through withholding (or will not pay enough tax during the year that way), pay the second installment of your 2011 estimated tax.

If you are a U.S. citizen or resident alien living and working (or on military duty) outside the United States and Puerto Rico, file Form 1040 and pay any tax, interest, and penalties due for 2010. If you want additional time to file your return, file Form 4868 to obtain four additional months to file. Then, file Form 1040 by October 17.

Corporations. Deposit the second installment of estimated tax for 2011.

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

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