Cynthia Dawkins: And now, the operator will give us instructions on how to ask a question.

Operator?

Coordinator: Thank you. At this time, I’ll begin the question and answer session.

Cynthia Dawkins: Operator, do we have a question in the queue?

Coordinator: One moment please.

If you would like to ask a question, press *1. One moment.

We do have a question from Michael Rusch. Your line is open.

Michael Rusch: Yes, I have a question. As far as a home sale goes, if in the tax year 2006, you sold a property and you received a statement from your mortgage broker indicating that you paid real estate taxes in 2006 for the property that you had sold, then in the tax year 2006 are you able to deduct the real estate taxes that you paid in 2006 on the old property at settlement, as well as the property taxes that were paid in the calendar year 2005, that were paid 2005 that were actually paid in 2006?

Jeff Schnepper: You're on a cash basis, and because you're on a cash basis, your property taxes are allowable as itemized deductions in the year that you pay them. So whatever real estate taxes you paid in 2006, even if
Michael Rusch: Okay. Now for the tax year coming up next year [2007], would you be allowed to deduct the property taxes that you're paying on your new property even if at the time of settlement the property taxes were paid to you as a credit by the seller?

Jeff Schnepper: No, not if you got a credit. That means you didn’t pay it.

Michael Rusch: Okay. But if you get the tax bill in 2007 and you pay the property tax for 2007 actually in 2006, you're not able to deduct that?

Jeff Schnepper: Well, if you were credited for those taxes at settlement…

Michael Rusch: Right.

Jeff Schnepper: You're only allowed to deduct the taxes in excess of the credit.

Michael Rusch: In excess of the credit.

Jeff Schnepper: Yeah. In other words, what you're allowed [to deduct is] what really came out of your pocket. So, if the taxes for the year… and I am making up a number … were $1,200 a year, and at settlement you got a credit for $200 that the seller had paid, then you actually are only out-of-pocket $1,000.

Michael Rusch: Okay.

Jeff Schnepper: And that’s what you're entitled to deduct.
Michael Rusch: All right, thank you.

Cynthia Dawkins: All right.

Operator, do we have another question?

Coordinator: Yes. Our next question is from Lois Bennett. Your line is open.

Lois Bennett: Hi, I have a two-part question.

I used a portion of my 401(k) for a home purchase last year. And my questions are: will the ensuing deductions that I gained from [buying] the home offset the repayment dollars [to the 401(k)]? And if the payment has to be made in installments, will there be a penalty?

Jeff Schnepper: Oh. Let me ask you a question, if I may. Was this … did you or your spouse own a home two years prior to this one?

Lois Bennett: No.

Jeff Schnepper: Okay. If that’s the case, then … You took it out of the 401(k) or an IRA?

Lois Bennett: 401(k).

Jeff Schnepper: Then, sorry about it. I'm thinking about avoiding the penalty [for early withdrawal], and it works with an IRA.

Ronald Hegt: With the IRA it works.
Jeff Schnepper: Yeah, but that doesn’t work with the 401(k). Absolutely right, Ron. That’s why I asked if it’s a 401(k) or an IRA.

Whether the deductions are going to exceed, you know, the penalty in the taxes you pay depends upon the magnitude of the deductions and the magnitude of what [the penalty] you're paying.

Let’s not let the tax tail wag the financial dog. If you needed the money to buy the house, and if the house was a good idea, and if this was your only opportunity to get the funds in order to acquire the house, then congratulations on being in debt to your bank. You have joined the rest of us.

Lois Bennett: Thank you.

Ronald Hegt: Now did you make a withdrawal from the 401(k) or did you borrow from your 401(k)?

Lois Bennett: I made a withdrawal.

Ronald Hegt: Oh. Okay.

Lois Bennett: My employer--or the way it was set up--didn’t allow for borrowing against [the 401(k)].

Ronald Hegt: Okay.

Jeff Schnepper: Yeah. Ron is absolutely right. Had you been able to borrow, it [the withdrawal] wouldn’t have been taxable. And the normal rule is that you can borrow about half of the…what you’ve got, up to about $50,000.
Lois Bennett: I'm batting zero.


Lois Bennett: Thank you.

So will there be penalties if I cannot pay the entire amount back?

Jeff Schnepper: When you say pay it back, if you…

Lois Bennett: It’s like, don’t you have to pay it right back the next year?

Jeff Schnepper: No, no. You are taxed on the distribution.

Lois Bennett: Okay.

Jeff Schnepper: The money is yours. You don’t have to pay it back again.

Carmen Aguiar: Right. And you get taxed at your tax rate plus, depending on your age, if you're under 59-1/2…

Lois Bennett: Yeah.

Carmen Aguiar: …10%…

Lois Bennett: Ten percent.

Carmen Aguiar: …additional.
Jeff Schnepper: Ten percent additional tax on top of the regular tax rate on the income.

Lois Bennett: Okay. So then the deductions that I gain from ownership [of the house] and all those different things, will they offset that amount?

Jeff Schnepper: They will help offset it.

Crosstalk

Lois Bennett: Okay, they will offset it.

Jeff Schnepper: Yeah, they will help.

Jeff Schnepper: Yeah. How much it’s going to offset is going to be a function of the deduction.

Lois Bennett: Okay, great.

Cynthia Dawkins: All right, thank you.

Lois Bennett: Thank you.

Cynthia Dawkins: Operator, do we have another question in queue?

Coordinator: Yes. Our next question comes from Jacenta Davis. Your line is open.

Jacenta Davis: Actually it’s for Carmen. She mentioned…it’s not really a question. I just wanted to get clarity. She mentioned something about if you have a gain on your home, and the sales price less improvements… I didn’t get all the information. I just wanted to get clarity on that, Carmen.
Carmen Aguiar: Okay. So basically what I was saying is, “How do you determine the gain?“ So the way you determine the gain on the house is you take the sales price, right?

Jacenta Davis: Okay.

Carmen Aguiar: And then you could subtract what your cost on that house is. And so it would be your cost--your original cost--plus improvements.

Jacenta Davis: Okay.

Carmen Aguiar: And one thing you've got to keep in mind though is the cost plus improvements, that’s kind of what we call your “basis”…

Jacenta Davis: Okay.

Carmen Aguiar: …in the house. And you have to have lived in it two years…

Jacenta Davis: Okay.

Carmen Aguiar: …owned it [the house] for two years, so you've got all those provisions.

But the other thing is … Is this the first time you're…have you sold a home before that had a gain?

Jacenta Davis: Yes, I have.

Carmen Aguiar: I'm sorry?

Jacenta Davis: Yes, I have.
Carmen Aguiar: Okay. So one thing you're going to need to do is you're going to have to go back to that tax return …

Jacenta Davis: Okay.

Carmen Aguiar: And see if there was a gain that was deferred.

Jacenta Davis: Okay.

Carmen Aguiar: And what that means is that your cost, your basis--remember I was talking about what your basis is--

Jacenta Davis: Yes.

Carmen Aguiar: may …will actually, you know…could potentially be lower. So the key thing is making sure you have tracked any improvements on the house you're selling, making sure you've accounted for all your selling expenses, right? Because all that reduces your gain.

Jacenta Davis: Okay.

Carmen Aguiar: And then once you calculate your gain…so suppose at the end of the day your gain is $300,000…

Jacenta Davis: Uh-huh.

Carmen Aguiar: Right?

Jacenta Davis: Yes.
Carmen Aguiar: If you're single, then $250,000 of that gain is tax free. If ... suppose your gain instead is only $100,000, right?

Jacenta Davis: Right.

Carmen Aguiar: Then that gain is [tax] free.

Jacenta Davis: Okay.

Now does it matter if my spouse had a home two years ago, as well, or how does that...

Carmen Aguiar: Oh you have...as far as if you have...so this...is it your...did he sell a home two years ago? Is that what you're saying?

Jacenta Davis: Well, we...I sold my condo, we moved into his home, and then a year and a half ago, we sold his house. So we both had homes within the last three years that we sold.

Carmen Aguiar: Okay. So you're going to have to look at...you're going to have to look at the limits on that.

Jacenta Davis: Okay.

Carmen Aguiar: And then...

Jeff Schnepper: It’s one exclusion every two years.

Carmen Aguiar: Two years, exactly.

Ronald Hegt: That’s correct.
Jeff Schnepper: You need to live in the home for two of the last five years to qualify for the exclusion, but the exclusion is available only once every two years, unless, under limited circumstances, you were forced to sell your home for what’s called unforeseen circumstances.

Carmen Aguiar: Exactly.

Jacenta Davis: Okay.

Ronald Heft: Now, under unforeseen circumstances as well, you can get a partial exclusion.

Jeff Schnepper: Right.

Jacenta Davis: Okay, thank you.

Cynthia Dawkins: All right, thank you.

Operator, do we have another question in the queue?

Coordinator: Yes. Our next question comes from Lillian Patterson. Your line is open.

Lillian Patterson: Okay. My question is I have rental property, and I experienced a loss due to wind damage, which I didn’t check my policy-- insurance policy-- and it’s not covered. My loss is about $15,000 worth of damage that I have to pay out of my pocket.
What I’d like to know is, is that deductible on my taxes or am I just out of…you know how can I recoup that, through taxes, on a rental property?

Jeff Schnepper: If it wasn’t covered by insurance and it’s on a rental property, then, you know, the replacement cost is going to be deductible.

Lillian Patterson: The full amount or just a certain percentage?

Ronald Hegt: Well, whatever you pay in order to fix that property is either going to be deductible or depreciable, depending upon the nature of the asset.

Lillian Patterson: Oh, okay. Thank you.

Cynthia Dawkins: Thank you.

Okay, operator, do we have another question in the queue?

Coordinator: The next question is from Jamie Thomas. Your line is open.

Jamie Thomas: Hi there.

This is probably for Carmen because I'm calling from Washington State.

I work with women who are going through a divorce, from an education basis, but we certainly talk about the importance of thinking about taxes as they’re going through a divorce. We are a community property state.
So if someone chose to file [her taxes] “married [filing] separately” and would--and I've never gotten a clear answer on this--but let’s say that the total [income] is maybe $20,000 income for the woman and $80,000 for the man, and they decide for whatever reason to file married [filing] separately in a community property state, how is that income...how does that income have to be reported per person?

Carmen Aguiar: Okay. One of the things…the very first key thing--and I deal quite a bit with divorce--is you really have to look at what the divorce decree says. And so what you need to do is almost look...there are a couple of things. You've got to look at when that income was coming in.

Jamie Thomas: Right.

Carmen Aguiar: Right. When [the] separation took place, right? When the divorce was final, right? So there are various key dates that you need to take into account in order to determine what’s the best way to allocate the appropriate income.

So in the simplest, simplest format, right, if the couple was together let’s say for the first three months, right, and everything was commingled, you would then have to take whatever income was earned at that time from both of them and split it 50/50.

If, once the divorce decree occurred, right, and accounts were separate-- everything was completely separate--then for that part of the year--and suppose the woman made $20,000--then that would be part of her income.

Now the key thing is that your filing status is based on what you are [your marital status] on the last day of the year.
Jamie Thomas: Right.

Carmen Aguiar: Okay? So if the divorce is not final, right, or you can't qualify under the abandoned spouse rule, then you would have to file either married filing jointly or married filing separately.

Jamie Thomas: Right. And that's really the situation I'm most interested in.

Carmen Aguiar: Okay.

Jamie Thomas: Before the divorce is final.

Carmen Aguiar: Right. So it all depends, you know…I really look at what the facts and circumstances are and what makes the most sense in terms of for the client and kind of what can be agreed on. Okay?

Jamie Thomas: Okay. I'm going to have…yeah, I'm going to have to research that further I think too.

Carmen Aguiar: Uh-huh.

Jamie Thomas: Thank you.

Carmen Aguiar: You're welcome.

Cynthia Dawkins: Thank you.

Okay, operator, are there other [questions] in the queue?

Coordinator: Yes, our next question comes from Mary Casey. Your line is open.
Mary Casey: Yes. Can you hear me? Hello, can you hear me?

Ronald Hegt: Yes, I can.

Jeff Schnepper: Yeah. Yes, we can.

Mary Casey: Okay.

This is my question. This goes back to...you were talking about the person who has not filed for several years.

Jeff Schnepper: Uh-huh.

Mary Casey: Okay. If...what happens if some of those years prior to the last three years were years where they didn’t owe taxes? In fact, they would have gotten a refund. Could they put those in payments so that...I mean I know they don’t get the refund, but can they put those in payments towards what they would owe?

Ronald Hegt: No. No, unfortunately you can't.

Jeff Schnepper: If you go back more than this—if you haven’t filed for more than three years-- the only thing you can use any payment for is liability that is owed for that year. So that if you have--again to just come up with some numbers—a $1,000 tax bill and $1,500 worth of payments, and you file your return four years late, you won't have to write a check but you won't be able to use that $500 excess against anything.

Mary Casey: Okay. So you cannot, say, toss it into the next year.
Jeff Schnepper: No.

Mary Casey: Okay. But I guess I want to understand this, because if you don’t owe any taxes for those years, is there a benefit for filing [for] those years?

Jeff Schnepper: Well, the…there is a benefit in that not filing is potentially a criminal act.

Mary Casey: Not if you don’t owe any money.

Ronald Hegt: Well, see, you claim you don’t owe any money, but the IRS doesn’t necessarily know that.

Jeff Schnepper: The IRS knows about your income, they don’t know about your deductions.

Ronald Hegt: Let me give you a perfect example. I had a young lady that I did her taxes for just recently. When the IRS came after her for not filing, she had sold a lot of stock and the IRS wanted hundreds of thousands of dollars in tax from her because the only thing that’s reported to the IRS is the sales price, the gross receipts. There was no offset for her basis for the cost of the stock that she had. By filing the returns, we turned the hundreds of thousands of dollars of liabilities into a couple of hundred dollars worth of liabilities.

See, the IRS doesn’t know that you don’t owe the money. That’s why you've got to file the returns.

Jeff Schnepper: And the other advantage for filing the return is if you don’t file a return, the IRS can ask you questions and challenge it forever because the statute of limitations--which is the period of time during which the
IRS can question you--doesn’t begin to run until you actually file the return.

So on a most…you know, a real far-out example, if you didn’t file a tax return in 1972, they could ask you questions about that now.

Cynthia Dawkins: All right, thank you.

Mary Casey: Thank you very much. I appreciate it.