



THE ELLS OUTLOOK

September-October 2009

Avoid the 1031 Booby Trap on “Cancellation of Debt” Income

In these times of depreciating property values, many investors with 1031 exchange property are dealing with a new type of tax created by having debt forgiven, or the cancellation of debt, referred to as COD. Situations that may generate this negative result are foreclosures, deed back in lieu of foreclosure, and short sales. The rules vary depending on whether the loan is recourse or non-recourse.

Some investors with 1031 exchange properties who have non-recourse loans are giving their properties back to their lenders, but are doing so without considering the potential tax consequences. Because their attention is focused on damage control, they may overlook the fact that the basis in the property is less than their loan balance, particularly so, when the property was originally acquired as part of a 1031 exchange. That triggers a “tax event” and can be a very expensive oversight. In cases where investors have recourse loans, COD income is triggered when a property’s fair market value is less than the loan balance. Another “tax event” trigger!

The tax can be significant. COD income is considered ordinary income and does not qualify for the lower long-term capital gain rate. When a taxpayer is considered insolvent the rule does not apply. For example, if a taxpayer has \$1,000,000 in liabilities, but only \$500,000 in assets, they are considered insolvent under the Internal Revenue Code. Therefore, a cancellation of a \$200,000 debt will not need to be reported as gross income. However, if a debt of \$600,000 is cancelled, the taxpayer will have \$100,000 in gross income to report because their total liabilities no longer exceed their total assets (cancelling \$600,000 in debt means the taxpayer now has only \$400,000 in liabilities).

As you can see, this isn’t a situation for amateurs to take on. When considering disposition of financially distressed 1031 exchange properties, investors should be certain that the consequence of COD income is an important consideration. As always, our message remains to call your ELLS advisor to evaluate all potential solutions before signing any documents. It isn’t possible to go back and undo an unfavorable transaction once it’s in cement.

A Tribute To

JOAN IRISH, CPA

September 9, 1950 - August 28, 2009



Joan Evelyn Irish was born in Detroit, Michigan. Her family relocated to California in 1956 where she grew up in Fullerton. She graduated from Sunny Hills High School and attended college majoring in Political Science. But numbers turned out to be her passion and she gravitated into an accounting career. She joined ELLS in 2003 as our Internal Accountant and became a member of our Professional Staff in 2006 after realizing her professional goal of passing the CPA exam and earning her CPA credentials.

Joan was our “go to” person at ELLS ... the staff could count on her cheerful disposition and her clients could count on her to keep a vigilant eye on their accounts. To sum it up, Joan loved people. She embraced the cultures and people she met during her world travels. At home, she maintained a close bond with her family and regarded her co-workers at ELLS as members of her extended family. On August 28th, Joan lost her valiant 3-year battle with cancer. Joan Irish was a very special person and we will all miss her.

Sherry Radmore Offers Tax Tips To Real Estate Investor/Owners



Like practically everything else, the real estate market is especially challenging these days. The following tax tips may help real estate owners and developers be more aware of tax planning opportunities and potential cash savings available to them.

Color Your Building Green. Whenever possible, take advantage of special deductions and tax credits for environmentally friendly features. You may be able to deduct the cost of energy-efficient improvements that are installed in part of the interior lighting system, heating, ventilating, and air-conditioning system, hot water system, or building envelope.

Take Full Advantage of Depreciation. Has your company recently undertaken new construction projects, expansions, or renovations? A cost-segregation study categorizes assets into the most appropriate and tax-advantaged depreciable lives. ELLS has saved our clients thousands of tax dollars with a cost segregation study.

Consider the Tax Impact of Charitable Land Contributions. Has your company thought about contributing land to a county, city, or state? Before contributing property, consult with your ELLS advisor and examine the alternative viewpoints the Internal Revenue Service could take with regard to your charitable motives to make sure your donation will be fully allowed.

Determine if You Are a Dealer or Investor. Do you know your status as either a dealer or an investor for tax purposes? Generally, ordinary income or loss is generated when a dealer sells property and capital gain or loss is generated when an investor sells property. Advance planning can ensure the desired treatment upon disposal of your property.

Your ELLS advisor has many tax saving ideas and strategies that can be maximized if careful planning and consideration are taken in advance.

Thank You For Referring Us
To Your Friends &
Business Associates!

Tax-Advantaged Places to Retire

Thinking about packing it up and moving to your retirement destination, but can't quite decide where the best place will be? All states attempt to collect the amount of money they will need to stay solvent. Some use a multifaceted approach, trying to balance tax on income, real estate and sales. Others collect from primarily one revenue source. If you are a high income/high net worth individual, you may want to avoid the states that attack you on income and estate tax. Consider that in one state you may pay higher real estate tax, but that might be more than offset by not having to pay state income tax. Federal taxes will be about the same no matter where you live.

State and local taxes can vary greatly. States that have no income tax are Washington, Nevada, Texas, Wyoming, South Dakota and Florida. New Hampshire and Tennessee tax dividends and interest income only. Four states have no sales tax: they are Oregon, Montana, New Hampshire and Delaware. States with the lowest median real estate taxes are Louisiana, Mississippi, Alabama, Arkansas and West Virginia. If you plan to purchase a lot of things and the "no sales tax states" don't appeal to you, you may be interested to know that Wyoming, Hawaii, Wisconsin, Virginia and Alaska have the lowest overall sales tax.

The least pension-friendly states are California, Nebraska, Vermont, Rhode Island and Connecticut. The highest income tax states are Oregon, California, Hawaii, Rhode Island and New Jersey. If you decide to relocate back east and go to New York, Connecticut, New Jersey, New Hampshire or Rhode Island, then expect to pay the highest real estate taxes.

Social Security benefits are taxed in 13 states and 15 states now impose their own estate tax. Your ELLS advisor has these lists, along with a sympathetic ear to help you sort out your choices and decide what will be most beneficial to you and your lifestyle.



ELLS CPAs sponsored a hole at the first annual Scleroderma Foundation Golf Tournament in Dove Canyon on September 21st. **Maria Arriola** is pictured with the tournament's honoree, 16-year old Lexi Pettit.

IRS Begins Mailing Refunds To Madoff Victims

The Internal Revenue Service (IRS) has begun sending refund checks to Madoff investors who paid taxes on investment income from the giant Ponzi scheme. While some clients who were Madoff investors have received refunds, most refunds are still in process.

The IRS issued guidance in March 2009, that clarified tax law and rules for claiming the theft loss deduction for investors in all Ponzi schemes. The guidance included a “safe harbor” provision which allows a U.S. investor in a Ponzi scheme to claim a theft loss deduction of 95 percent of their net investment losses in the year the theft is discovered, including any fictitious income included on prior-year tax returns. Any unused losses may be carried back three years or in some cases, five years. October 15th is the deadline for establishing your claim on losses as well as carryback provisions, so that the IRS cannot say that the statute of limitations applies. If you have not already done so, be sure to contact your ELLS advisor if you were a victim of Madoff’s Ponzi scheme. Time is running short!

A Festive Summer Outing To Benefit Charity



Commercial Real Estate Women (CREW) members Shareholder **Maria Arriola** and ELLS Marketing Director **Jill Zozula** attended the CREW Annual Summer Party at the Balboa Yacht Club in Corona del Mar on August 18th. It was one of those perfect California afternoons down by the water! The purpose of the party was to raise money for the local charity WisePlace. Pictured with Maria are fellow CREW members Tricia Adamson of Thomson Reuters and Karen Priesman, Vice President of Hager Pacific Properties.

— Around The Calculator —

Anniversary celebrations are a big part of life at ELLS in the fall months. Shareholder **Sherry Radmore** started us off on September 16th with 24 candles on her Anniversary Cake. **Kerry Osborne** of ELLS Audit & Assurance (A & A) professional staff followed right along with her 2nd anniversary on September 17th. Tax professional staff member **Jeff Boxx** found that his 3 years at ELLS as of September 25th went by faster than he thought possible. And ending out September, we saluted **Ali Mian** for completing one year as part of our very busy A & A team. A & A Manager **Lee Weir** started off October festivities as she ushered in her 9th year on October 4th. **Nancy Chung**, of our tax professional staff, will ring up her 3rd year on the 10th, and **Joanne Tang** of our A & A professional staff will finish off October celebrating her 2nd year on the 17th.

Shareholder Ed Lieber Once Again Steps Up To The Plate

Ed Lieber served in his usual role as Director at the 12th Annual Sertoma Fantasy Baseball Camp dedicated to teaching deaf and hard-of-hearing youths the fundamentals of baseball. Over 30 campers were in attendance at the popular camp held August 10th to 14th at Boysen Park in Anaheim. Ed is pictured with Anaheim Police Chief John Welter, who came out to meet the campers and lend his support.



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HIGHLIGHTS OF ELLS VACATIONS THIS SUMMER



Alisha Ayub enjoys a refreshing coconut drink as she takes a break from sight-seeing in Dar-es-Salaan in Africa.



Kerry Osborne went camping and fishing at Cachuma Lake in Santa Barbara



Ron Stumpf enjoys playing with granddaughter Gracie at Angels Camp campground.



Jeff Jordan had a great time at the Comi Con convention in San Diego in July.



Kelley Bendt headed to Pismo Beach with her boyfriend, Joe, and his family. "The weather was great and the beach was beautiful!"



Now that's just plain ridiculous! Well, maybe not. After all, Greg Lewis was at the Bennington, Vermont, Moosefest in June when this was taken, so perhaps it's appropriate.



Tricia Maas, her daughter, Jenny, and family took in wine tasting in Napa, visited Luther Burbank's home in Santa Rosa, and biked at Point Reyes National Seashore.