2009

INCOME TAX DEVELOPMENTS

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2009 NEW TAX LAW LETTER

Responding to fears of a deep recession, Congress has been passing economic stimulus legislation at a frantic pace. This legislation includes a host of *temporary* tax breaks for both individuals and businesses. Most recently, Congress passed the ***American Recovery and Reinvestment Tax Act of 2009,*** granting *individual* taxpayers various tax breaks, including: an increased refundable first-time home buyer's credit of up to $8,000; estimated tax payment relief for certain individuals; a deduction for sales tax on the qualifying purchase of new vehicles; an increased and partially refundable tuition tax credit; a refundable income tax credit to offset payroll taxes of low and middle income taxpayers; a significant expansion of various credits for energy-efficient home improvements; and alternative minimum tax (AMT) relief. On the *business* front, the 2009 legislation: provides for a longer carryback period for 2008 Net Operating Losses; expands the work opportunity tax credit for hiring certain disadvantaged employees; and extends through 2009 accelerated business asset write-offs including the higher $250,000 179 deduction, and the 50% bonus depreciation.

> **Caution! Since several of these tax relief provisions expire in 2009** (and others expire in 2010), **you will need to be proactive to obtain maximum benefits from this legislation!**

In addition to recent tax legislation, there have also been significant other tax developments including IRS releases, court cases, etc. For example, we have ***new IRS guidance*** involving: who gets to claim the tax benefits for children of divorced or separated parents; tax relief for certain defrauded investors; rules for taxing death proceeds from employer-owned life insurance policies; and how to avoid tax traps by properly completing beneficiary designation forms for IRAs and retirement accounts. There have also been several ***recent Court cases*** that will impact tax planning, including: court decisions enhancing the ability of LLC owners to avoid the passive loss restrictions, and a court case exposing the pitfalls of failing to re-name your beneficiaries under your retirement plan or IRA after a divorce.

In light of these significant changes, we are sending you this letter to keep you abreast of the major tax developments that we believe have the greatest impact on our clients. To help you locate items of interest, we have divided the developments into the following categories:

- **Recent Tax Legislation**
- **New Tax Breaks Available to *Individual* Taxpayers-Selected Provisions**
- **New Tax Breaks Available to *Business* Taxpayers-Selected Provisions**
- **2009 Developments *Other Than New Legislation***
- **Tax Developments Impacting Primarily *Individual* Taxpayers-Selected Provisions**
- **Tax Developments Impacting Primarily *Business* Taxpayers-Selected Provisions**

> **Planning Alert!** We highlight only *selected* provisions of the new tax legislation, cases, and IRS releases. If you have heard or read about any tax development not discussed in this letter, feel free to call our office. This letter also contains planning ideas. However, you cannot properly evaluate a particular planning strategy without calculating your overall tax liability (including the alternative minimum tax) with and without the strategy. You should also consider any state income tax consequences of a particular planning strategy. We recommend you call our firm before implementing any tax planning technique discussed in this letter, or if you need more information.

RECENT TAX LEGISLATION

Earlier this year, President Obama signed the *American Recovery and Reinvestment Tax Act of 2009* (the "2009 Act") providing approximately $275 billion of temporary tax breaks and incentives impacting virtually every individual and business. Also, late last year, Congress passed a law that waives ***for 2009 only*** the required minimum distributions from employer retirement plans and IRAs. The following are *highlights* from this tax legislation.

Planning Alert! As you read the following highlights, please keep in mind that many of these tax breaks are **scheduled to expire at the end of 2009,** so you may need to act quickly! To help you easily identify those provisions, we have ***highlighted prominently*** the ***effective date*** and ***sunset date*** (if applicable) of each new provision. Also, several of these tax benefits phase out as your 2009 income exceeds certain thresholds. These phase-out thresholds are generally linked to your 2009 adjusted gross income (AGI) or modified adjusted gross income (MAGI). Pay careful attention to these income thresholds for each new provision, which we also ***highlight prominently*** in each segment. Furthermore, you will notice that the *2009 Act* provides for several *refundable* tax credits. This generally means that to the extent the refundable credit exceeds the taxes that you would otherwise owe (without the credit), the IRS will actually send you a check for the excess.

New Tax Breaks Available To *Individual* Taxpayers Selected Provisions

First-Time Home Buyer's Refundable Credit *Expires After 11/30/09!* For 2008, first-time home buyers who satisfied certain income thresholds were eligible for a refundable credit of up to $7,500 for purchases of a principal residence after April 8, 2008 and before 2009. However, this credit must be paid back to the government in equal installments over 15 years, or earlier if the house is sold or the purchaser fails to use the home as a principal residence.

Caution! These rules continue to apply to qualifying home purchases **after April 8, 2008 and before 2009** (including the 15-year payback requirement). However, for **qualifying first-time home buyers who purchase a home after 2008 and *before December 1, 2009***, the *new law* expands and enhances the credit by: **1)** increasing the maximum credit from $7,500 to $8,000 (not to exceed 10% of the home's purchase price), **2)** eliminating the 15-year payback requirement, and **3)** requiring recapture of the credit upon the sale of the residence or failure to use the residence as a principal residence *only* where the sale or change of use occurs within 36 months of the date of purchase. The credit is phased out as your modified adjusted gross income (MAGI) increases from **$75,000 to $95,000** if you are single, or from **$150,000 to $170,000** if you are married filing jointly.

Planning Alert! This law has been modified and extended. Please see our complete analysis of **The Worker, Home Ownership and Business Assistance Act of 2009**which was signed into law on November 6, 2009.

Tax Tip. This is a *refundable* credit that offsets both alternative minimum tax (AMT) and regular tax liabilities, so you will actually get a refund to the extent the credit exceeds your tax liability.

Who Is A Qualified First-Time Home Buyer? You are a "first-time home buyer" if neither you nor your spouse has owned an interest in a principal residence in the U.S. during the 3-year period ending on the date you purchase the current residence. A principal residence could include a condominium, houseboat, or mobile home. IRS says that a mobile home will qualify even if you place it on a lot you are leasing.

Planning Alert! The purchase date is generally the date you close on the house, so you should make sure that you actually *close on the house* before **December 1, 2009.**

2009 Estimated Tax Relief. Generally, if your **2008 AGI** was $150,000 or less, one way you can avoid 2009 underestimated tax penalties is to make your timely 2009 estimated tax payments based on 100% of your 2008 tax liability. If your **2008 AGI** was over $150,000, you can avoid penalties by basing your 2009 estimated tax payments on 110% of your 2008 tax liability. Under the *2009 Act*, if you meet certain conditions, you now have another way of avoiding underestimated tax penalties **for 2009 only!** If you qualify, you can eliminate 2009 underestimated tax penalties by basing your 2009 estimated tax payments on 90% (rather than 100% or 110%) of your 2008 tax liability. To qualify: **1)** you must have had adjusted gross income below $500,000 ($250,000 if married and filing separate returns) **for 2008**, and **2)** you *must certify* that more than 50% of the gross income on your 2008 return came from a qualifying small business. For this purpose, a qualifying small business is generally defined as a business that employed on average less than 500 employees during calendar-year 2008.

New* Sales Tax Deduction On Vehicle Purchases.** For purchases **from February 17, 2009 through December 31, 2009**, you may claim a deduction for sales or excise taxes you pay on the purchase of a qualified motor vehicle. If you itemize deductions, you may deduct the qualified sales or excise taxes as taxes. If you do not itemize deductions, you may deduct the qualified sales or excise taxes as an additional standard deduction. A ***qualified motor vehicle is a *new* passenger automobile with a gross vehicle weight (GVW) of 8,500 lbs or less, a new motorcycle with a GVW of 8,500 lbs or less, or a new motor home. This additional deduction for sales or excise taxes is limited to the sales tax on the first $49,500 of the vehicle's purchase price, and phases out ratably as your modified adjusted gross income (MAGI) increases from **$250,000 to $260,000** on a joint return (**$125,000 to $135,000** on a single return).

Expanded But *Temporary* American Opportunity Education Tax Credit. Before 2009, individuals were allowed a HOPE tuition tax credit (HOPE Credit) for qualifying tuition costs generally for the first two years of a student's college (e.g., freshman and sophomore years). **For 2009 and 2010,** The *2009 Act* changes the name of the HOPE credit to the ***American Opportunity Tax Credit*** and makes five significant changes: **1) Amount of Credit** the maximum credit is increased from $1,800 to $2,500 (100% of the 1st $2,000 of qualifying education expenses plus 25% of the next $2,000 of qualifying expenses); **2) Number of Years Credit Allowed** the total number of years that a student may qualify for the American Opportunity Credit is increased from *two* years to *four* years (i.e., generally, freshman through senior years); **3) AGI Phase-Out Limits** the credit is phased out as your modified adjusted gross income increases **from $160,000 to $180,000 for those filing joint returns** (**$80,000 to $90,000 for single filers**); **4) Partially Refundable** 40% of the credit is refundable *unless the person claiming the credit* is subject to the so-called *kiddie tax rules* (i.e., all students under age 18 and most full-time students under age 24); and **5) Qualifying Education Expenses** course materials are added to the expenses qualifying for the credit (therefore, for **2009 and 2010**, expenses qualifying for the credit include tuition, fees, and *required course materials)*.

Making Work Pay Tax Credit. For **2009 and 2010**, if you have *earned income*, you may qualify for a new refundable *Making Work Pay* **tax credit up to $800 for joint filers and $400 for single filers.** However, the credit is phased out as your **modified adjusted gross income (MAGI) increases from $150,000 to $190,000 ($75,000 to $95,000 on a single return).** Instead of receiving a rebate check as you did with last year's economic stimulus payment, the IRS has reduced the federal income tax withholding by the amount of the credit. So, most taxpayers have already received the benefit of the credit by having their 2009 take-home pay increased by the amount of the credit. However, if you qualify for this credit for 2009 but you do not have sufficient withholding to utilize all of the credit, you will be entitled to any unpaid portion as a refundable credit when you file your 2009 tax return.

Expanded Tax Credits For Making Energy-Efficient Improvements To Your Home. Starting in 2005, Congress gave us several *nonrefundable* credits for making certain energy-efficient improvements to our homes, and for installing qualified solar panels and solar water heaters. **Starting in 2009**, the *2009 Act* dramatically enhanced these credits.

Tax Tip. Unlike many other tax benefits, these credits are not reduced or eliminated as your AGI increases, and they offset the AMT. Therefore, you may qualify regardless of your income level. For example, the *2009 Act* now allows you a 30% credit for qualified energy-efficient home improvements to your *principal residence located in the U.S.* **and placed in service in 2009 and 2010**, with a $1,500 maximum cumulative credit for the 2009 and 2010 tax years (previously, there was a lifetime credit limit of $500). Qualified improvements can include *properly certified* energy efficient roofs, insulation, exterior windows (including skylights), exterior doors, heat pumps, hot water boilers and air conditioners. In addition, the *2009 Act* allows a 30% credit for qualified *residential* solar water heaters, geothermal heat pumps, wind energy property, and solar electric generating property installed in your residence. **The residence need not be your "principal residence,"** so installations in your second residence or vacation home may qualify. Also, the credit will now offset the alternative minimum tax as well as regular tax.

Planning Alert! Expenditures related to swimming pools or hot tubs (e.g., solar equipment to heat water or run electrical pumps) generally do not qualify.

Waiver Of Required Minimum Distributions (For 2009 Only!). During the last weeks of 2008, Congress passed a law waiving required payments (called required minimum distributions or RMDs) from employer-sponsored retirement plans and IRAs for **calendar year 2009 only.** Thus, if you have reached age 70 1/2 , or you are a beneficiary of an IRA or employer-sponsored plan whose owner has passed away, you will generally not be required to take a distribution otherwise due in 2009. **If you reach age 70 1/2 in 2009**, you have **until December 31, 2010** to take your first required distribution.

Temporary Tax Relief For Unemployment Benefits (2009 Only). Taxpayers are frequently surprised to learn that unemployment benefits are taxable. **However for 2009 only**, the *2009 Act* exempts up to $2,400 of unemployment benefits from federal income taxation. Unemployment benefits exceeding $2,400 will still be taxed.

> **Tax Tip.** If you and your spouse each receive unemployment benefits during 2009, each of you can exclude up to $2,400.

New Tax Breaks Available to *Business* Taxpayers Selected Provisions

Fiscal Year Business May Still Have Opportunity To Elect The Temporary 5-Year Carry Back Of Net Operating Losses. If a taxpayer has a net operating loss (NOL) for a tax year, the NOL may generally be carried back and offset taxable income reported in the 2 tax years before the year of the loss (the "carry back period"), and then carried forward to each of the following 20 years until the NOL is used up. Under the *2009 Act*, for NOLs generated by an **"eligible small business"** (a business with average gross receipts of no more than $15 million) in the tax year **ending in 2008**, taxpayers may "elect" an extended NOL carry back period from 2 years to up to 5 years.

> **Planning Alert!** The due date for making this election by a 2008 *calendar-year* taxpayer has expired.

> **Tax Tip.** Fiscal-year taxpayers may still elect the extended carryback period of up to 5 years for the tax year *beginning* in 2008 if the extended carryback period was not elected for the tax year *ending* in 2008. If you own a fiscal-year eligible small business that has a net operating loss for the tax year **beginning in 2008** that still qualifies for this election (typically a regular C corporation using a fiscal year having average gross receipts not exceeding $15 million), please call our office. We will help you determine whether or not you should elect an extended NOL carryback period.

> **Please Note!** As we complete this letter, there are proposals in Congress to extend this expanded NOL carryback period to certain NOLs generated after 2008.

Increased $250,000 Section 179 Deduction Extended Through 2009. Last year, Congress increased the maximum 179 deduction for the cost of qualifying new or used depreciable business property (e.g., machinery and equipment) from $128,000 to $250,000 for property placed-in-service in tax years beginning in 2008.The *2009 Act* has now extended this $250,000 cap for an additional year, to **property placed-in-service in tax years beginning in 2009.** Thus, if your business is a *calendar-year* taxpayer, the increased 179 deduction will be available for qualified property placed-in-service **by December 31, 2009.**

The 50% Bonus Depreciation Also Extended Through 2009. Last year, *Congress* reinstated the 50% bonus depreciation deduction for calendar-year 2008 property acquisitions. The *2009 Act* extends the 50% bonus depreciation for one more year. Therefore, the 50% bonus depreciation deduction is available for **new** qualifying property **acquired and placed-in-service during calendar years 2008 and 2009.** Generally, *qualifying property* includes property that has a depreciable life for tax purposes of *20 years or less* (e.g., machinery and equipment, furniture and fixtures, cars and light general purpose trucks, sidewalks, roads, landscaping, depreciable computer software, farm buildings, qualified leasehold improvements, and qualified motor fuels facilities).

> **Planning Alert!** Whether your business uses a fiscal or calendar tax year, the 50% bonus depreciation is allowed only if qualified property is acquired and placed-in-service **during calendar years 2008 or 2009.** To meet the placed-in-service requirement for 2009, property must be ready and available for use **by December 31, 2009. Passenger Automobiles.** The maximum first-year depreciation deduction (including the maximum 179 deduction) for most *business automobiles* is generally capped at $2,960 **for 2009** ($3,060 for trucks and vans not weighing over 6,000 lbs). However, the *2009 Act* increased the first-year

depreciation cap by $8,000 for autos qualifying for the 50% bonus depreciation in 2009. **Trucks And SUVs Over 6,000 Lbs.** Trucks and SUVs with loaded vehicle weights over 6,000 lbs are generally exempt from the passenger auto annual depreciation caps discussed above. However, the 179 deduction for an **SUV is limited to $25,000** (instead of $250,000). On the other hand, **pickup trucks** with loaded vehicle weights over 6,000 lbs **are *not* subject to the $25,000 limit** imposed on SUVs, if the truck bed is at least six feet long.

New Incentives To Hire Unemployed Veterans And Disconnected Youth. If your businesses employs workers who are members of certain targeted groups (e.g., certain low income employees, welfare recipients, ex-felons, summer youth employees), you may qualify for the *Work Opportunity Tax Credit* (WOTC*).* The credit is 40% of the first $6,000 of qualifying wages (up to $2,400 per employee). **For employees who begin work in 2009 or 2010,** the *2009 Act* created two new categories of individuals qualifying an employer for the 40% WOTC: **1)** *unemployed veterans*, and **2)** *disconnected youth*.

Planning Alert! A business must properly certify the employee in order to qualify for the WOTC. You can generally satisfy this certification requirement by having the employee complete a *pre-screening notice* (**IRS Form 8850**) before the employee begins working. Also, no later than 28 days after the employee begins working, you must submit the properly executed notice to the appropriate state employment security agency for certification.

Tax Tip. Be sure to use the most recent **Form 8850** and the related instructions which contain information on the two new categories of qualifying employees (*unemployed veterans* and *disconnected youth*) as well as the other targeted groups qualifying for the WOTC. Form 8850 and the related instructions are available at www.IRS.gov.

Deferral Of Income Recognition From Cancellation Of Business Debt in 2009 or 2010. Generally, a business has *cancellation of debt* (COD) income where the debt of the business is cancelled or where the business reacquires its debt for an amount less than its face amount. However, under the *2009 Act*, a business may elect to defer its COD income resulting from the cancellation or the reacquisition of a debt instrument that was issued by the business **if the forgiveness or reacquisition takes place in 2009 or 2010**. If the election is made, qualified COD income that would otherwise be recognized in **2009 or 2010** will be **deferred until 2014**, and then included ratably in income over the next 5 tax years (i.e., from 2014 through 2018).

Tax Tip. The IRS has recently released detailed guidance on the technical application of these rules, and the procedures for making the election. These rules are quite detailed, please call our firm if you need additional information.

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2009 TAX DEVELOPMENTS *OTHER THAN NEW LEGISLATION*

Tax Developments Impacting Primarily *Individual* TaxpayersBSelected Provisions

Be Sure To Review Beneficiary Designation Forms! If you are participating in a qualified retirement plan (e.g., 401(k) plan), or you have an IRA, several 2009 developments illustrate the importance of properly completing your beneficiary designation forms. For example, in a recent U.S. Supreme Court case, the court held that a deceased individual's balance in his retirement plan passed to his former spouse whom he divorced years earlier, even though the former spouse waived her rights in the plan under the divorce decree. After the divorce, the decedent failed to change his beneficiary designation form that named his former spouse as beneficiary of his retirement plan. Also, the IRS recently ruled that a decedent whose IRA beneficiary designation form stated that the account balance was to pass "as stated in wills," must treat the decedent's estate as the designated beneficiary (instead of treating the beneficiaries of the estate as the IRA beneficiaries). By making this common mistake, the beneficiaries lost a significant tax deferral opportunity.

> **Tax Tip.** Please review your beneficiary designation forms to ensure you have properly completed them. We will be glad to review your IRA and retirement plan beneficiary designation forms and suggest any tax savings opportunities.

New Rules For Waiving A Child's Dependency Exemption. **Starting in 2009,** the rules and forms for determining who gets the dependency exemptions for children of divorced or separated parents changed. These changes include: **1)** allowing a "custodial" parent to revoke for future years a previous assignment of a child's dependency exemption to the "noncustodial" parent; **2)** for divorce decrees and agreements **entered into in a tax year beginning after July 2, 2008**, a general requirement that a court decree or written separation agreement will no longer constitute a valid waiver by the custodial parent of a child's dependency exemption (a properly executed Form 8332 will generally be required); and **3)** more clarification of which parent is considered the "custodial" parent (i.e., generally the parent with whom the child spends the larger number of nights during the year).

> **Planning Alert!** If you have questions concerning these new rules, please call our office. In addition, please call us if you are contemplating a divorce or separation. Divorce or separation can dramatically impact your tax situation. Planning ahead is the key to avoiding tax problems down the road.

IRS Provides Tax Relief To Investors In Ponzi And Other Similar Schemes. Ponzi and similar scams have victimized taxpayers for years. In response to the significant investor losses caused by Bernard Madoff's fraudulent activities, the IRS issued comprehensive guidance that applies to investors caught in Ponzi-style fraud whether perpetrated by Madoff or someone else. Overall, the guidance takes a generous, pro-taxpayer position. Among other things, IRS allows the losses to be claimed as ordinary losses rather than capital losses. The IRS guidance also establishes safe-harbors for qualifying taxpayers that provide more certainty regarding: **1)** the year that the theft loss may be deducted, and **2)** the amount of the theft loss. **Please call our firm if you need additional information.**

In Certain Jurisdictions, Deficient Powers Of Attorney May Foil Estate Plans. Powers of Attorney are commonly executed as part of an estate plan. Also, utilizing lifetime gifts (including maximizing the $13,000 annual gift tax exclusion) are frequently used as a tool for saving estate taxes. A recent tax case reminds us that to ensure the gifts are not included in the decedent's taxable estate, the Power of Attorney should *expressly* authorize lifetime gifts on behalf of the grantor of the power.

> **Planning Alert!** If lifetime gift giving is part of your estate plan, you should make sure that your Power of Attorney expressly authorizes the holder of the power to make lifetime gifts on your behalf (assuming that you are comfortable in granting that authority).

Tax Developments Impacting Primarily *Business* Taxpayers Selected Provisions

Closely Scrutinize Employer-Owned Life Insurance On Employees' Lives. Generally, life insurance proceeds received by a beneficiary of a life insurance policy are income tax free. However, in 2006, Congress enacted legislation that generally requires an employer, that is the beneficiary of a life insurance policy on the life of its employee, to treat all or a portion of the death benefits as taxable income to the company. This new rule applies only to contracts **issued after Aug. 17, 2006**. However, even under these new rules, the company can still treat the death proceeds as tax free if the company satisfies certain written notification requirements to the employee.

> **Planning Alert!** These new rules could commonly apply to a key-man life insurance arrangement, or life insurance policies owned by a company to fund shareholders' buy-back provisions. The IRS recently announced that in order to avoid taxation on the proceeds of these employee life insurance policies, the employer must satisfy the *required notice and consent requirements* **before the policy is issued!** This announcement also provides guidance on what contracts are covered by these rules, how the exceptions apply, and the notice and consent requirements for excluding the death benefits from income.

Courts Give LLC Owners A Potential Reprieve From Stringent Passive Loss Rules. If you own an interest in a pass through entity (general partnership, limited partnership, limited liability company (LLC), limited liability partnership (LLP), or S Corporation) that is generating a tax loss, you are not allowed to immediately deduct that pass through loss on your personal return if the loss is classified as passive and you have no passive income. Under these so-called passive loss rules, subject to limited exceptions, losses generated by a Alimited partnership are presumed to be passive with respect to the partnership's limited partners. On the other hand, general partners have much easier standards to satisfy in order to avoid the passive loss restrictions. The IRS has generally applied these *limited partner* restrictions to all owners of LLCs and LLPs, even though these owners are technically not limited partners under the laws of most states.

Good News! Three recent court cases rejected this longstanding IRS position and, instead, concluded that owners of LLCs and LLPs should be treated as general partners under the passive loss rules.

Be Wary Of Passive Loss Trap When Leasing Property To Your Closely-Held Corporation. Owners of a closely-held C corporation frequently own the business's office building, warehouse, etc. individually (or through a partnership or LLC), and lease the facility to their corporation. However, a recent Tax Court case reminds us that this leasing arrangement can also create a passive loss trap. In this case, the Tax Court concluded that any rental loss generated from the shareholders' leasing property to their controlled C corporation, will generally be classified as a passive loss. Therefore, the shareholders must suspend the loss, and will not be able to deduct the rental loss on their current returns unless they have other passive income.

> **Tax Tip.** To avoid this trap, the shareholders should set the lease payments at a level (assuming the lease amount is reasonable) so that the rental property does not generate a tax loss.

Pay Careful Attention To Payments On S Corporation Shareholder Loans. Shareholders frequently loan funds to their S Corporation, creating basis for the shareholder to utilize pass-through losses. If all or a portion of the loan is paid back after the loan's basis has been reduced by previous pass-through losses, the shareholder will recognize a gain on the repayment. The amount, character, and timing of the gain is dependent on several factors.

> **Planning Alert!** The IRS has recently issued exhaustive final regulations establishing detailed rules for the tax treatment of payments on S shareholder loans that have a tax basis less than the face amount of the debt. The regulations create several tax traps as well as planning opportunities.

> **Tax Tip.** Please consult with us before you make any payments on your shareholder loans. We will help you structure the loans and any loan repayments to your maximum tax advantage.

FINAL COMMENTS

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes and we will gladly discuss any current tax developments and planning ideas with you. Please call us before implementing any planning ideas discussed in this letter, or if you need additional information. Please note that the information contained in this material represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of these provisions may apply to a specific situation.

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