

tax report

MAY 2009

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Uncle Sam to Taxpayers: Are You Ready To Buy?

The American Recovery and Reinvestment Act of 2009 (the 2009 Act) includes several temporary tax provisions designed to encourage consumers and companies to buy big-ticket items.

New Vehicles

The state and local sales taxes you pay generally are not deductible on your federal income-tax return unless you elect to deduct them as an itemized deduction *instead of* deducting state and local income taxes. Under the 2009 Act, eligible taxpayers may deduct state and local sales and excise taxes paid on new motor vehicles purchased after February 16, 2009, and before January 1, 2010 — *in addition to* deducting state and local income-tax payments. The deduction for qualified motor vehicle taxes also may be claimed by taxpayers who do not itemize their deductions.

The deduction is available for the taxes paid on up to \$49,500 of the cost of a new passenger automobile, light truck, motorcycle, or motor home. Vehicles other than motor homes must have a gross vehicle weight rating of no more than 8,500 pounds. The deduction phases out for taxpayers whose modified adjusted gross income (AGI) is between \$125,000 and \$135,000 (\$250,000 and \$260,000 on a joint return).

First Homes

The 2009 Act liberalizes a tax credit for the purchase of a first home. For principal residences purchased after December 31, 2008, and before December 1, 2009, the credit is

10% of the purchase price, capped at a maximum credit of \$8,000 (\$4,000 on a married-separate return). Formerly, the credit limit was \$7,500 (\$3,750 on a married-separate return). The credit for a 2009 purchase does not have to be repaid unless the home is resold (or otherwise ceases to be the taxpayer's principal residence) within 36 months of purchase. And the credit may be claimed on the taxpayer's 2008 or 2009 return. Since the credit is refundable, first-time home buyers can benefit even if the credit exceeds their tax liability.



The credit is available to taxpayers who have not owned a principal residence in the U.S. during the three-year period before the purchase. As a result, the home doesn't necessarily have to be your *first* home. The credit phases out for taxpayers with modified AGI between \$75,000 and \$95,000 (\$150,000 and \$170,000 on a joint return).

Machinery, Equipment, etc.

The 2009 Act extends a provision allowing businesses to claim a 50% first-year depreciation "bonus" for qualifying purchases of new machinery, equipment, and computer software and for certain leasehold improvements. The property generally must be placed in service in the business before January 1, 2010. In addition, the \$250,000 limitation on the Section 179 expense deduction is extended to tax years beginning in 2009. The deduction begins to phase out once qualifying asset purchases exceed \$800,000. ■

On the Hook

In a recent case,* a corporation's general manager was found to be a "responsible person" personally liable for the company's unpaid federal employment taxes of over \$279,000. The tax payments were skipped because the company was experiencing financial difficulties.

The general manager explained that he had simply done what a representative of the family that owned the company had told him to do — give priority to paying suppliers to keep the business operating. The manager was aware that the employment taxes were not being paid but said that he reported to the family member, got payment priorities from him, and did not have authority to override him.

But the court wasn't convinced. The manager was in charge of the company's finance and accounting functions. Even though the family member had more control over creditor payment, the manager still had significant control — enough to make him liable for the taxes as a responsible person.

* Smith v. U.S., CA-10, 2/17/2009

short takes

Refund Tracking

The IRS maintains a secure website that taxpayers can use to track the status of their personal tax refunds. You can access the site by going to www.irs.gov and clicking on the appropriate link. You'll need your Social Security number, filing status, and the exact whole dollar amount of your refund.

401(k) Compliance

An updated version of a work plan for the IRS's Employee Plans group says that 401(k) plan compliance issues will be a priority for the remainder of the 2009 fiscal year.

Roth IRA Conversions

Starting in 2010, the income restrictions that limit the ability of higher income taxpayers to convert a traditional individual retirement account (IRA) to a Roth IRA will be lifted. Although income taxes are payable on a conversion, the income from a 2010 conversion may be spread out over the next two years. A Roth IRA offers the potential for tax-free earnings. There are no required minimum distributions from a Roth IRA during the owner's lifetime.

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.

On the College Front

Most people would agree that having a college education can pay big dividends. Coming up with the money to pay for college is the hard part. If you have a Section 529 college savings plan or are paying college bills this year, here are a few recent developments you may find helpful.

Investment Changes

A Section 529 plan normally may allow an account holder to change the investment strategy selected for an account only one time per year and when a new beneficiary is designated. However, given the extreme volatility in the economy and the stock market, the IRS has loosened this rule somewhat. For calendar year 2009 only, a plan may permit two changes in investment strategy, as well as a change if a new beneficiary is designated. The goal is to give people a little more flexibility with their plan investments.

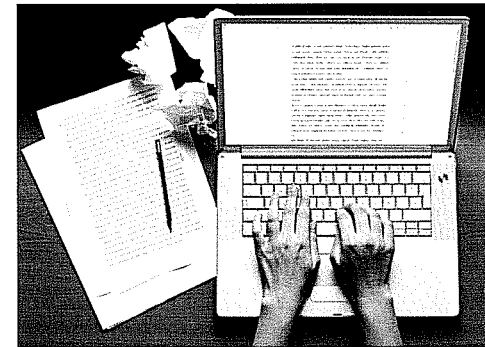
Computer Costs

Section 529 plan distributions are tax free if used for qualified higher education expenses. In addition to tuition and fees, these expenses generally include room and board for students who attend at least half-time, books, supplies, and equipment required for enrollment or

attendance, as well as expenses for special needs students. For 2009 and 2010, tax-free withdrawals are also allowed to pay for computer technology, equipment, and related services, including Internet access. (Restrictions apply.)

American Opportunity Tax Credit

Also for 2009 and 2010, the Hope Scholarship Credit has been renamed the American Opportunity Tax Credit and made more generous — up to \$2,500 per student per year. The income phaseout ranges also have been raised. The new credit phases out for taxpayers with modified adjusted gross income (AGI) between \$80,000 and \$90,000 (\$160,000 and \$180,000 on a joint return). ■



Work Opportunity Tax Credit

These days, businesses need all the help they can get in keeping their payroll costs under control. Hiring individuals who belong to certain targeted groups can qualify an employer for a federal Work Opportunity Credit. The credit is generally calculated as a percentage of first-year wages and is worth up to \$2,400 per eligible employee — or more in some cases. Employees must complete at least 120 hours of service.

The American Recovery and Reinvestment Act of 2009 has expanded the targeted groups to encompass unemployed veterans and disconnected youth who begin work during 2009 and 2010. To be included in the new targeted group, veterans must have:

- Received unemployment compensation for at least four weeks during the one-year period ending on the hiring date

- Been discharged or released from active duty in the Armed Forces at any time during the five-year period ending on the hiring date

A disconnected youth is defined as a person who:

- Is age 16-24 on the hiring date
- Has not regularly attended school or been regularly employed during the six-month period before the hiring date
- Is not readily employable due to a lack of a sufficient number of basic skills

A designated local agency must provide certification that the individual meets these criteria.

There are several additional targeted groups covered by the credit. For more information about the credit, please get in touch with us. ■

COBRA Q&As

Employers that maintain group health plans subject to a federal law known as COBRA are facing new requirements mandated by the American Recovery and Reinvestment Act of 2009. Very generally, the new law provides a 65% premium subsidy for nine months to employees who elect COBRA coverage as a result of involuntary termination of employment between September 1, 2008, and December 31, 2009.

Although the subsidy is government-provided, employers generally must administer it. And that could prove to be tricky. The discussion below answers some questions that may arise.

What coverage periods are affected? The premium subsidy applies to periods of coverage beginning after February 16, 2009 (e.g., on March 1 for a plan that charges for COBRA coverage on a calendar-month basis). The subsidy ends after nine months, when the individual becomes eligible for other group coverage or Medicare, or when the maximum period of COBRA coverage ends, whichever occurs first.

How is the 65% subsidy paid? After receiving 35% of the otherwise required COBRA premium from an eligible person, the employer is responsible for paying the remaining 65% of the premium. The IRS will treat the 65% premium payment as a payment of payroll taxes by the employer.

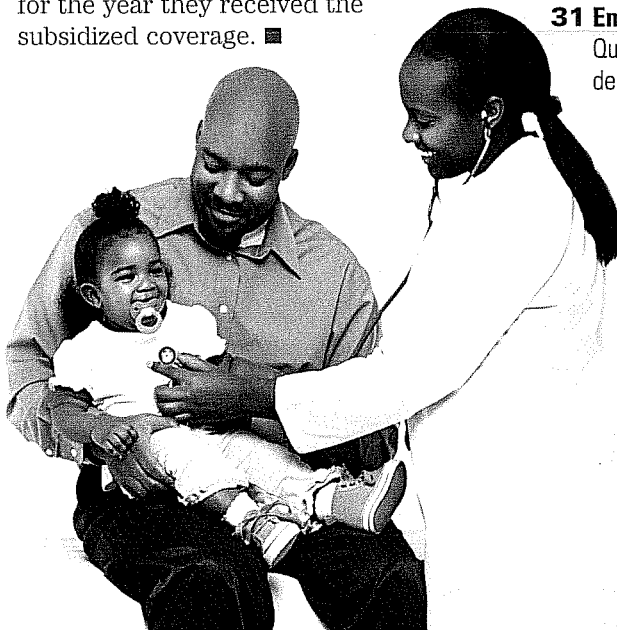
How do employers take credit for their subsidy payments? Credits are claimed on employers' payroll tax returns (quarterly Form 941 or annual Form 943 or 944). The amount an employer pays as a premium subsidy (65%) during the quarter is treated as having been deposited on the first day of the quarter. The IRS will apply the amount against the employer's deposit requirement and will not assess a failure-to-deposit penalty if the employer chooses to reduce its deposits during the quarter by the amount of the subsidy. The premium subsidy and the related employer credit apply only after the individual has paid his or her 35% share of the premium.

Does the credit have to be claimed in the same quarter the subsidy is paid? The credit generally could be claimed on Form 941 for a later quarter in the same year, if desired.

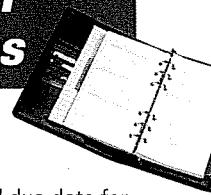
What is the special grace period? The special grace period for electing COBRA coverage applies to individuals involuntarily terminated from September 1, 2008, through February 16, 2009, who refused COBRA coverage when it was offered or elected COBRA but later dropped the coverage. These individuals have until 60 days after the plan provides them notice (the notification deadline was April 18, 2009) to elect COBRA and take advantage of the premium subsidy. The coverage elected during this special election period begins with the first period of coverage beginning on or after February 17, 2009.

Does the premium subsidy apply to a self-insured group health plan? The subsidy requirements do apply to self-insured plans subject to COBRA. Basically, employers with self-insured plans must provide subsidized coverage to eligible individuals who pay 35% of the otherwise required premium.

Is the COBRA subsidy taxable income to recipients? The subsidy is not included in income when paid. However, higher income recipients will have to repay the subsidy (in full or in part) by increasing their tax liability for the year they received the subsidized coverage. ■



Calendar of Filing Dates



MAY

- 11 Employers:** Deferred due date for Form 941, if timely deposits were made.
- 15 Exempt Organizations:** File 2008 Form 990 or 990-EZ, Return of Organization Exempt from Income Tax, if the organization reports on a calendar-year basis. Small organizations file Form 990-N, e-Postcard.
- 15 Partnerships and S Corporations:** If an election to use a tax year other than a required tax year was made, file Form 8752 to report the required payment.

JUNE

- 15 Individuals:** Second installment of 2009 estimated tax due; file Form 1040-ES.
- 15 Corporations:** Deposit second installment of estimated income tax for 2009, if the organization reports on a calendar-year basis.

JULY

- 31 Employee Benefit Plan Sponsors:** File 2008 Form 5500 series returns/reports. If your plan is not a calendar-year plan, file the form by the end of the seventh month after the plan year ends.
- 31 Employers:** File Form 941, Employer's Quarterly Federal Tax Return; quarterly deposit due.

Paying the IRS

Owners of unincorporated businesses generally make quarterly payments to the IRS to cover their estimated taxes for the year. Like other taxpayers who pay estimated taxes, business owners generally can avoid an underpayment penalty if their total estimated tax payments equal or exceed *the lesser of*:

- 90% of the current year's tax liability or
- 100% of the *preceding year's* tax liability. For 2009 estimated tax purposes, 110% is substituted for 100% if the taxpayer's 2008 adjusted gross income (AGI) was over \$150,000 (\$75,000 if married filing separately).

The American Recovery and Reinvestment Act of 2009 gives eligible small business people a different option for the 2009 tax year: Estimates may be based on just 90% of their 2008 tax liability (if that amount is less than 90% of 2009's tax liability). To qualify, 2008 AGI must be less than \$500,000 (\$250,000 if married filing separately), and the individual must certify that more than half of the gross income shown on 2008's return was income from a trade or business that had fewer than 500 employees on average.

Small business people who can use the new option gain the benefit of making lower estimated tax payments during the year but still could owe the IRS additional taxes next April if they haven't paid enough to cover their actual tax liability. ■

Higher Exemption Could Affect Your Estate Plan

The federal estate-tax exemption (technically, the "applicable exclusion amount") is \$3.5 million this year. This marks the end of a series of increases in the exemption mandated by a 2001 tax law.* If President Obama's estate-tax proposal is enacted, the exemption will stay at \$3.5 million (or close to it) for the foreseeable future.**

The \$3.5 million exemption is a tax-saver compared to the lower amounts previously in effect. But it throws a monkey wrench in the existing estate plans of some married couples whose plans provide for a credit shelter (often called a bypass or family) trust.

The Plan

A credit shelter trust plan ensures that the estate-tax exemptions of both spouses are used. Instead of transferring all property to one's surviving spouse, the plan calls for an amount equal to the exemption to be placed in a trust upon the first spouse's death. The trust gives the surviving spouse the right to trust income and, perhaps, a limited power to withdraw principal. When the second spouse dies, the trust's beneficiaries (typically the couple's children) receive the property. Using this plan means that the trust property escapes estate tax in *both* spouses' estates.

The Problem

Now that the exemption has jumped up to \$3.5 million, some couples are finding that their plans *as written* place too much in



the credit shelter trust, potentially depriving the surviving spouse of the trust-free assets he or she would need to live comfortably. Why? Their estate documents call for funding the credit shelter trust with whatever the exemption amount is at the time of death. Just last year, the exemption was \$2 million; not long ago (in 2003), it was \$1 million.

Conversely, a plan that calls for a specific dollar amount to be placed in the credit shelter trust may place less than desired in the trust, potentially wasting part of the first spouse's \$3.5 million exemption. Either problem can be fixed by having an attorney amend the appropriate documents. ■

* The 2001 law repeals the federal estate tax for 2010 and reinstates it in 2011 with a \$1 million exemption.

** The President's 2010 budget proposal assumes that the estate tax, as it is currently in effect in 2009, is permanently extended and indexed to inflation.