tax report

JANUARY 2009

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Financial Rescue Package Restores Favorable Tax Provisions

In crafting the financial rescue legislation* that was enacted last October, Congress extended several tax law provisions helpful to taxpayers.

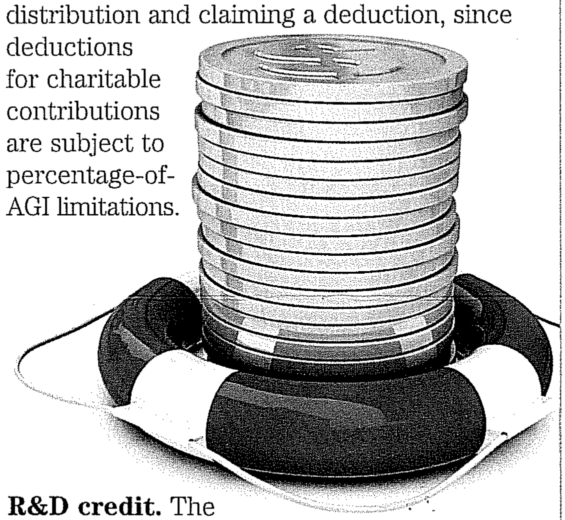
Sales-tax deduction. The option of deducting state and local general sales taxes instead of state and local income taxes will again be available to taxpayers who itemize their deductions for the 2008 and 2009 tax years. The sales tax deduction is calculated using standard IRS tables or by tallying actual sales taxes paid during the year.

College tuition deduction. Extended for 2008 and 2009, this deduction is for the payment of qualifying higher education expenses. The applicable deduction limit ($2,000 or $4,000) is based on the taxpayer's income. No deduction is available if adjusted gross income (AGI) is more than $80,000 ($160,000 on a joint return) or if any taxpayer claims an education credit for the student's expenses.

Classroom expense deduction. For several years, eligible educators who buy K-12 classroom supplies have been able to deduct up to $250 of their out-of-pocket expenses. Thanks to the new law, this deduction will continue to be available for 2008 and 2009.

Property-tax deduction. The Housing Assistance Tax Act of 2008 introduced an additional standard deduction for the 2008 payment of state and local real property taxes. The deduction is limited to $500 ($1,000 on a joint return) or the actual amount of taxes paid, if less. The rescue legislation extends the new deduction through 2009.

IRA charitable rollover. Taxpayers age 70½ or older who are interested in contributing money held in an individual retirement account (IRA) to charity may find it worthwhile to take advantage of this provision, which has been extended through 2009. If accomplished via a direct trustee-to-trustee transfer of funds, the rollover is tax free. While no deduction for the rollover contribution would be available, the rollover option may still be preferable to taking a taxable IRA distribution and claiming a deduction, since deductions for charitable contributions are subject to percentage-of-AGI limitations.



R&D credit. The research and development credit has been extended through 2009 with certain modifications.

Depreciation. Qualified leasehold, restaurant, and retail improvements are eligible for 15-year straight line cost recovery if placed in service before 2010. A much longer depreciation period normally applies to most commercial real estate. ■

* P.L. 110-343, October 3, 2008

AMT Relief

Even if you've never had to pay the alternative minimum tax (AMT), you shouldn't assume it won't apply to you. This filing season, it was anticipated that the number of taxpayers with an AMT liability would increase by more than 20 million. Fortunately, legislative action has been taken to alleviate the situation.

Higher AMT exemption amounts. The 2008 exemption amounts had been scheduled to drop to the amounts that applied in 2000. However, they've now been raised to $69,950 (married filing jointly), $46,200 (single), and $34,975 (married filing separately). Exemptions are phased out when AMT income exceeds certain levels.

Personal tax credits. As was the case for 2007, certain tax credits may offset both regular tax and the AMT.

AMT credit. The AMT credit has been liberalized to assist taxpayers who have paid the AMT on "phantom" income from the exercise of incentive stock options.

short takes

Separate EINs Needed

Effective with wages paid in 2009, a single-owner limited liability company (LLC) that has employees must secure an employer identification number (EIN) and use the LLC's name and EIN when paying federal employment taxes and filing required forms. The owner's name and tax ID may no longer be used. Qualified Subchapter S subsidiaries also need to have their own EINs.

2009 Social Security Taxable Wage Base

In 2009, the maximum amount of wages subject to the Social Security portion of the FICA tax is $106,800. The 2008 Social Security taxable wage base was $102,000.

Federal Gift-tax Annual Exclusion Increases

For 2009, the first $13,000 of gifts to any person (other than gifts of future interests in property) are not subject to federal gift tax. The IRS periodically adjusts the gift-tax annual exclusion for inflation. Last year it was $12,000.

SEPPs — Path to Penalty-free IRA Withdrawals

It's generally a good idea to leave any money you have in a traditional individual retirement account (IRA) alone until you are at least age 59½. Why? The tax law imposes an additional 10% penalty on the taxable portion of IRA distributions taken prematurely, unless an exception applies. One little-known penalty exception is available to IRA owners who take substantially equal periodic payments (SEPPs) from their accounts.

How Much?

The IRS has several "safe harbor" methods for calculating the required SEPP amount. Payments must be taken at least annually and are either fixed or recalculated annually, depending on which method you use.

How Long?

Once you start taking SEPPs, you'll have to continue for a minimum of five years or until you reach age 59½, whichever comes *later*. So, if you begin a SEPP program at age 45, you'll have to continue making withdrawals for 14½ years — until you turn 59½. If you begin taking SEPPs at age 58, you'll have to take withdrawals for five years, or until you reach age 63.

What happens if you want to stop taking SEPPs before the end of the required SEPP period? Generally, you'll have to pay a 10% penalty plus interest on the amounts you withdrew under the SEPP arrangement before reaching age 59½. ■

Who Gets the Exemption?

Dependency exemptions of up to $3,650 per child and a child tax credit of as much as $1,000 per child are among the important tax breaks available to parents of qualifying children. When a child's parents are divorced, the question of which parent is entitled to claim these tax benefits is often an issue.

Custody Matters

In newly finalized rules that take effect for tax years beginning after July 2, 2008, the IRS has clarified that the dependency exemption for a qualifying child goes to the *custodial* parent unless the noncustodial parent obtains a signed waiver for the tax year and attaches it to his or her tax return. This rule applies regardless of what the divorce decree says.

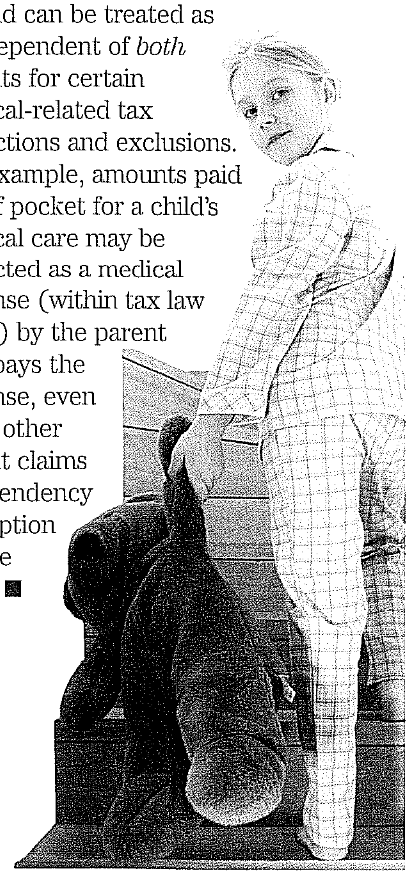
Counting Nights

What happens if one or both parents have the right to physical custody of a minor child for more than half the year — where the parents have joint custody, for example? For tax purposes, the parent with whom the child resides longer during the year is considered the custodial parent. Records should be kept of the number of nights the child sleeps at each parent's residence (whether or not the parent is there), as well as the nights the child sleeps away from home in the company of each parent (on vacation trips, for example).

Unless a waiver is signed, the parent who has the child for the most nights generally will be entitled to the dependency exemption. (A different test applies if a parent works at night.)

Both Parents' Dependent

A child can be treated as the dependent of *both* parents for certain medical-related tax deductions and exclusions. For example, amounts paid out of pocket for a child's medical care may be deducted as a medical expense (within tax law limits) by the parent who pays the expense, even if the other parent claims a dependency exemption for the child. ■



Going Green

Higher energy prices and environmental concerns have prompted a great deal of interest in greener technology. The Energy Improvement and Extension Act of 2008* (the "Energy Act") provides a number of energy-related tax breaks to individuals and businesses.

Solar and Wind Power

Since 2006, homeowners who installed qualified solar water-heating systems and photovoltaic systems to produce electricity have been eligible for a 30% tax credit toward the cost of their systems ($2,000 maximum annual credit for each type of system). The Energy Act extends the credit for eight years (through 2016) and modifies it so that, after 2008, the $2,000 credit limit will no longer apply and taxpayers may use the credit against the alternative minimum tax (AMT). In addition, the 30% business credit for solar energy property has been extended through December 31, 2016.

The Energy Act also creates a 30% credit on the installed cost of small wind turbines for residential and commercial applications. The credit for small wind turbines is capped at $4,000. It applies to turbines placed in service through 2016, and, like the solar energy credit, it may be used to offset the AMT.

Geothermal Heat Pumps

Effective for periods after October 3, 2008, for tax years ending after that date, the Energy Act expands the business energy credit to include a 10% credit for geothermal heat pump systems — equipment that uses the ground or ground water as a thermal energy source to heat a structure or as a thermal energy sink to cool a structure. Unless extended, this credit won't be available for property placed in service after December 31, 2016.

Energy Efficient Homes and Commercial Property

The Energy Act extends for one year the business credit available to contractors for the construction of qualified new energy efficient homes, so that the credit will continue to be available for homes acquired in 2009. The credit is $2,000 for a 50% reduction in energy usage or $1,000 for a 30% reduction.

In addition, the new law extends through 2013 the deduction for the cost of "energy efficient commercial building property" installed as part of a building's envelope; interior lighting systems; or heating, cooling, ventilation, and hot-water systems. The maximum deduction over all tax years for any building is $1.80 per square foot.

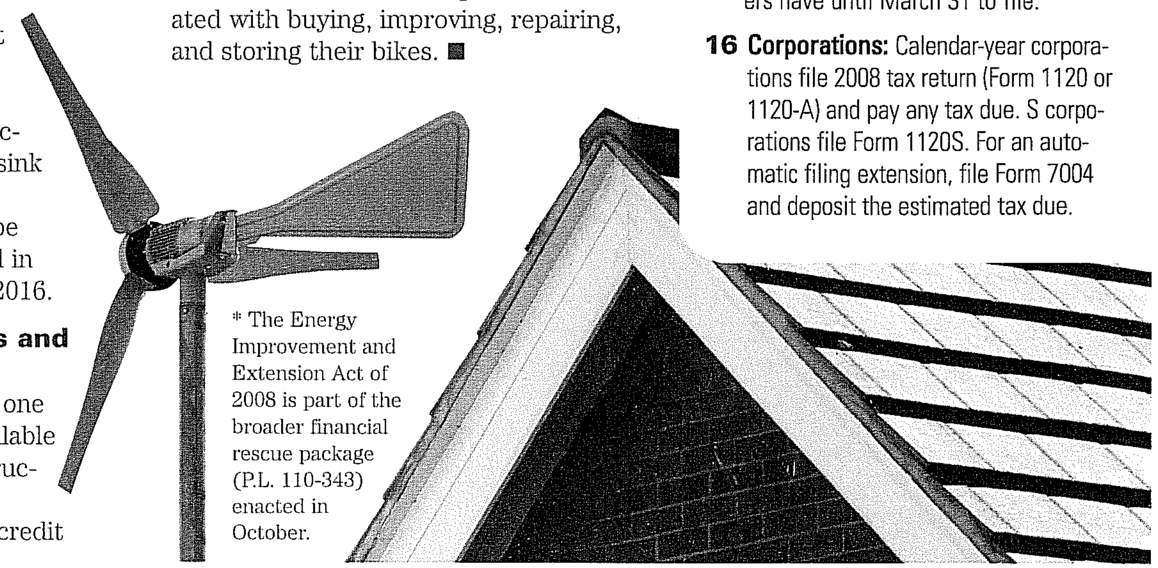
Plug-in Electric Vehicles

Under prior law, a tax credit has been available to buyers of IRS-certified hybrid, alternative fuel, and fuel cell vehicles. (Credit amounts vary.) Recently, the IRS announced that certain advanced lean-burn technology vehicles, which generally run on diesel fuel, are also eligible for a credit.

The Energy Act adds a tax credit for "new qualified plug-in electric drive motor vehicles." The credit will range from $2,500 to $7,500 for light-duty vehicles. A larger credit will be available for heavier vehicles. The new credit is effective for tax years beginning after 2008 for property purchased before 2015.

Bicycle Commuting Fringe Benefit

Effective for tax years beginning after 2008, the Energy Act allows employers to reimburse employees who regularly ride bicycles to work up to $20 a month on a tax-free basis for expenses associated with buying, improving, repairing, and storing their bikes. ■



* The Energy Improvement and Extension Act of 2008 is part of the broader financial rescue package (P.L. 110-343) enacted in October.

Calendar of Filing Dates

JANUARY

15 Individuals: Pay last installment of 2008 estimated tax with Form 1040-ES. Or file 2008 income-tax return and make full payment of any balance due by February 2.

FEBRUARY

2 Employers: Distribute copies of Form W-2 for 2008 to employees.

2 Businesses: Distribute Forms 1099 (or other information statements) to recipients of certain payments made in 2008. See us for more details.

2 Employers: File Form 941, Employer's Quarterly Federal Tax Return; quarterly deposit due.

2 Employers: File Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, for 2008.

10 Employers: Deferred due date of Forms 940 and 941, if timely deposits were made.

MARCH

2 Businesses: File 2008 Forms 1099 with the IRS. Electronic filers have until March 31 to file.

2 Employers: Paper filers must file 2008 Forms W-2 (together with transmittal Form W-3) with the Social Security Administration. Electronic filers have until March 31 to file.

16 Corporations: Calendar-year corporations file 2008 tax return (Form 1120 or 1120-A) and pay any tax due. S corporations file Form 1120S. For an automatic filing extension, file Form 7004 and deposit the estimated tax due.

2009 Plan Limits

Every year, the IRS adjusts various tax law limits applicable to retirement plan contributions and benefits for inflation. Here's a look at some key limits for 2009.

- Elective deferrals to 401(k) and 403(b) plans can total as much as $16,500 in 2009. The limit is $22,000 for employees age 50 or older making catch-up contributions.
- SIMPLE plan deferrals are limited to $11,500 ($14,000 with catch-up contributions).
- Annual additions to a profit sharing or other defined contribution plan account can total up to $49,000 for 2009. Additions include employer and employee contributions, as well as any forfeitures allocated to the account.
- The maximum annual benefit that may be funded for a participant in a defined benefit plan is $195,000.
- The maximum amount of compensation that may be considered in computing qualified plan contributions or benefits is $245,000.
- The limit on individual retirement account (IRA) contributions (excluding rollovers) did not change. For 2009, the maximum IRA contribution is $5,000 ($6,000 for individuals age 50 and older). IRA contributions may not exceed compensation. One limit applies to all traditional and Roth IRAs maintained for an individual. ■

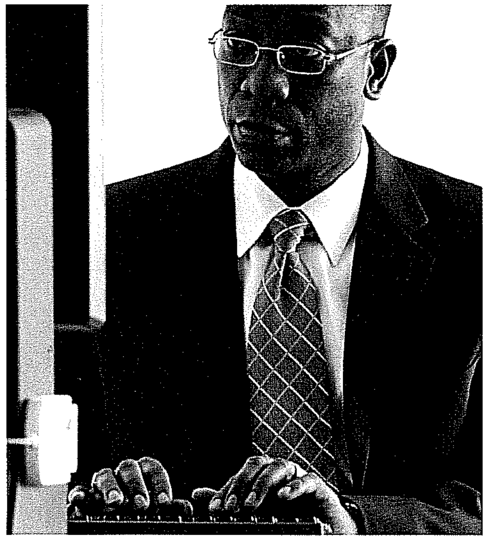
Correcting Retirement Plan Errors

A retirement plan is a desirable benefit that can help an employer recruit and retain good employees. A plan also can provide significant tax advantages *if* it complies with an array of complicated rules. Due to the complexities involved, it's not uncommon for employers to make errors in operating their plans. Since noncompliance can result in the loss of plan-related tax benefits, an employer that discovers problems with its plan should consider taking advantage of the IRS's Employee Plans Compliance Resolution System (EPCRS).

Two EPCRS programs allow employers to correct errors voluntarily, before the IRS uncovers the mistakes. A third program is restricted to the correction of failures the IRS has identified during an audit of the plan.

Self-correction Program. SCP permits an employer to correct certain operational errors (failure to follow the terms of the plan) without contacting the IRS. There is no fee involved, and, if the errors are insignificant, they generally may be corrected at any time. Even some errors considered to be significant may be self-corrected if the plan has a favorable determination letter and the correction is substantially completed by the end of the second plan year after the plan year of the failure.

Voluntary Correction Program. VCP requires the employer to submit proposed corrections to the IRS for approval and obtain the IRS's written approval for



making the corrections. A limited fee is charged for using this program.

Audit Closing Agreement Program. Audit CAP is restricted to violations discovered on audit. Instead of disqualifying the plan, the IRS requires the employer to pay a negotiated monetary sanction.

Recent changes in the EPCRS provide employers with some new opportunities to correct certain plan problems. For example, the updated EPCRS features streamlined application procedures for many issues. Among them: failing to amend a plan for law changes, problems with loans made to participants, and failing to make required minimum distributions to participants. The IRS will reduce the fee for correcting plan loan failures under VCP by 50% in many cases. ■