

Tax News: Winter 2009

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Meetings are by appointment only.

Happy Holidays!

Since this is the final edition of Tax News in 2009, I want to take a moment to thank each you for your loyalty, and we at 4-Serenity wish you a Happy Thanksgiving, a Merry Christmas, and a Blessed and Prosperous 2010.

New Legislation

Worker, Homeownership, and Business Assistance Act of 2009 – Passed on November 6, 2009
Latest Updates!

First Time Homebuyers Credit – The credit has been extended for purchases made between 12/01/2009 through 04/30/2010. You must enter into a binding contract by May 1, 2010 and close on the house by July 1, 2010. The refundable credit is still up to \$8,000 or 10% of the purchase price.

Non-First-Time Homebuyers Credit – Effective for purchases between November 7, 2009 and April 30, 2009, you may be eligible for a refundable credit of up to \$6,500 if you purchase a home. You must have owned and lived in your present home for any five-consecutive of the past 8 years, and the new home must be your primary residence. [The *loophole* is that you can keep your old home as a rental property and still qualify for the credit.]

Net Operating Loss Carryback – The special five year carryback for business net operating losses that was in effect for tax year 2008 has been extended for 2009.

Mandatory Electronic Filing – Paid tax preparers, such as me, are now required to file all tax returns electronically. Fortunately we already do.

S-Corporation and Partnership Late Filing Penalties

– The new law increases the late filing penalty on S-Corps and Partnerships from \$89 to \$195 per shareholder or partner for each month or part of a month (up to 12 months) that the return is filed late.

Personal Taxes

Plug-in Electric Vehicle Credits

Go green and save!

You may be able to claim one of three credits for plug-in electric vehicles manufactured primarily for use on public streets, roads, and highways. Vehicles manufactured for use on a golf course do not qualify.

- (1) The plug-in electric drive motor vehicle credit is available for newly purchased qualified vehicles placed in service for business or personal use after 2008.
 - For 2009, the amount of the credit varies depending on the battery capacity and the weight of the vehicle and ranges from \$2,500 to \$15,000.
 - After 2009, the credit tops out at \$7,500, depending on the battery capacity. To qualify, vehicles must be newly purchased, have four or more wheels, have a gross vehicle weight rating (GVWR) of less than 14,000 pounds, and draw propulsion using a rechargeable battery with at least four kilowatt hours.

(2) The plug-in electric vehicle credit is available for certain vehicles purchased after February 17, 2009, and before January 1, 2012. The credit equals 10 percent of the cost of a new vehicle, up to a maximum credit of \$2,500. You can either purchase:

- Certain low-speed vehicles (i.e., four-wheeled vehicles with a GVWR of less than 3,000 pounds) that are propelled to a significant extent by a rechargeable battery with a capacity of at least 4 kilowatt hours; or
- A two- or three-wheeled vehicle (i.e., motor scooter, motorcycle, etc.) with a GVWR of less than 14,000 pounds that is propelled to a significant extent by a rechargeable battery with a capacity of at least 2.5 kilowatt hours.

For 2009, you cannot claim this credit for a vehicle that qualifies for the plug-in electric drive motor vehicle credit. You cannot claim both credits for the same vehicle.

(3) The plug-in conversion credit applies to property placed in service after February 17, 2009, and before January 1, 2012. The credit equals 10 percent of the cost of converting any motor vehicle (new or used) to a qualified plug-in electric drive motor vehicle, up to a maximum credit of \$4,000. You may claim this credit even if you already claimed a hybrid vehicle credit for the same vehicle in an earlier year.

Check out <http://www.pluginamerica.org> and <http://www.eaaev.org> for more information on plug-in electric vehicles.

Making Work Pay Credit and Pensions *Should you adjust withholding?*

In February 2009, the government reduced the withholding tables for the Making Work Pay Credit. If you are receiving a pension and have no earned income, you do not qualify for the Making Work Pay Credit. However, if you have withholding from your pension payments, you may not have enough, and may end up owing more taxes when you file your tax return.

Pension payors were provided an optional procedure for additional withholding on pension payments to offset the withholding reductions for the Making Work Pay Credit. However, they are not required to use this procedure, so you should check with your pension plan administrator.

If your pension payor does not use the optional adjustment procedure, you can increase your withholding by filing Form W-4P, Withholding Certificate for Pension or Annuity Payments. If you submitted a Form W-4P to request additional withholding after the 2009 February withholding tables were issued, and your pension payor is using the optional adjustment procedure, you may want to submit a new Form W-4P to get rid of the additional withholding.

Earned Income Credit (EIC) *Should you request an advance payment?*

In 2009 and 2010, there is an increased EIC for taxpayers with three or more qualifying children. The EIC reduces the tax you owe, and gives you a refund even if you do not owe any tax. In 2009, you may be able to claim the credit if:

- You have three or more qualifying children and your earned income and adjusted gross income (AGI) are less than \$43,279 (\$48,279 if married filing jointly). The most you can get is \$5,657.
- You have two qualifying children and your earned income and AGI are less than \$40,295

(\$45,295 if married filing jointly). The most you can get is \$5,028.

- You have one qualifying child and your earned income and AGI are less than \$35,463 (\$40,463 if married filing jointly). The most you can get is \$3,043.
- You have no qualifying children and your earned income and AGI are less than \$13,440 (\$18,440 if married filing jointly). The most you can get is \$457.

If you think you will be eligible for the EIC and you have at least one qualifying child, you may choose to get advance EIC payments (up to \$1,826) with your pay by completing Form W-5, Earned Income Credit Advance Payment Certificate, and giving it to your employer. If you are entitled to an EIC greater than the amount advanced, you may claim the additional amount on your 2009 tax return.

Be careful requesting advance EIC payments! If you get advance payments and you are not eligible for the EIC, you must pay back these payments when you file your 2009 tax return. First, consult your tax professional to make sure you qualify for the EIC.

Qualifying Child

Do you need to adjust your withholding?

If you want to claim someone as a dependent, the individual must be a qualifying child or a qualifying relative. In 2009, the definition of a qualifying child was revised. Now:

- Your qualifying child must be younger than you;
- A child cannot be your qualifying child if he or she files a joint return, unless the return was only filed to claim a refund; and
- If the parents can claim the child as a qualifying child but no parent so claims the child, no one else can claim the child as a qualifying child unless that person's AGI is higher than the highest AGI of any parent of the child.

These new provisions generally affect siblings and grandparents. Those parents who didn't benefit from the dependency exemption because their income was too high can no longer have a younger child claim an older sibling as a qualifying child to benefit from the earned income credit (EIC). In addition, siblings and grandparents cannot claim a child as a qualifying child if the parents can claim the child and either of the parent's AGI is higher than the sibling's or the grandparent's. If

you are affected by these provisions, you may need to adjust your withholding.

0-Percent Capital Gains Rate

Tax-free step-up in basis?

If you have owned stock with a low basis for more than a year and think the stock will continue to go up in value, now may be the time to sell it if all of the gain on the sale falls within the 10- or 15-percent income tax brackets. In this case, the gain on the sale is taxed at the 0-percent capital gains rate. In addition, if you buy the stock right back, you effectively receive a tax-free step-up in basis.

You may be thinking that the gain on the sale is disallowed under the wash sale rules when you buy identical stock within 30 days of selling it. However, the wash sale rules only disallow losses on such sales.

The 0-percent capital gains rate is available through 2010. To qualify for the 0-percent capital gains rate in 2009, your income (including long-term capital gains) must be under \$33,951 (single and married filing separately), \$67,901 (married filing jointly), and \$45,501 (head of household). Ordinary income uses up the 10- and 15-percent income tax brackets before long-term capital gains, so if you have a lot of W-2 income, you will not qualify for the 0-percent capital gains rate.

Section 1202 Gain Exclusion

Thinking of selling qualified small business stock?

It may be wise to hold off selling your qualified small business stock if it is issued in 2009 or 2010. In general, you can exclude 50 percent of the gain on the sale of qualified small business stock that was held for more than five years. However, the remaining 50 percent of the gain is taxed at the 28-percent capital gains rate, so the entire gain on the sale is effectively taxed at a rate of 14 percent.

For qualified small business stock issued after February 17, 2009, and before January 1, 2011, the 50-percent exclusion is increased to 75 percent. Thus, only 25 percent of the gain is taxed at the 28-percent rate, which effectively taxes the entire gain at a rate of 7 percent. You still need to hold the stock for five years, so you'll have to project your tax situation five years from now to determine if it's worth the wait.

Exercising an Incentive Stock Option?

How to avoid the alternative minimum tax (AMT)

In general, when you buy stock by exercising an incentive stock option (ISO) and don't sell that stock in the same year, you could be subject to AMT. For regular tax purposes, no income is recognized when an ISO is

exercised. However, additional income is recognized for AMT purposes equal to the excess of the stock's FMV on the date of exercise over the exercise price. Therefore, you may be taxed on income you haven't even received (phantom income).

Don't be caught off guard and end up with an unexpected tax liability when you go to file your tax return. If you exercised an ISO early in the year and the stock has been rapidly declining ever since, consider selling the stock before the end of the year. There is no AMT adjustment when stock that was acquired by exercising an ISO is sold in the same year, so you can avoid paying tax on phantom income. Otherwise, if you want to hold onto the stock and don't want a big tax liability at year-end, you can make estimated tax payments. Also, the additional tax triggered by the AMT adjustment for ISOs generates a minimum tax credit (MTC) that may reduce your regular tax in future years.

Note: If you owed AMT attributable to the exercise of ISOs for 2007 or any prior year, the amount still owed as of October 3, 2008, was abated. However, your MTC must be reduced accordingly. In addition, any unpaid interest and penalties with respect to such unpaid AMT as of October 3, 2008, were abated. If you already paid such interest and penalties, you can increase your MTC. You should have received a Letter 2719C from the IRS detailing the amount of tax, interest, and penalties that were abated.

Roth IRAs

Is this a good place to put your money?

Roth IRAs can be more beneficial than other retirement accounts because qualified distributions are not taxable, and you don't have to take required minimum distributions when you reach the age of 70½. However, you cannot make a Roth IRA contribution when your income exceeds certain limits. For 2009, the Roth IRA contribution limit is phased out (reduced) when your modified adjusted gross income (AGI) is between \$105,000 and \$120,000 (\$166,000 and \$176,000 if married filing jointly).

If your income is too high to make a Roth IRA contribution for 2009, you can still make a contribution to a traditional IRA. In general, the contribution will be nondeductible if you or your spouse is covered by a retirement plan at work, but it will give you basis in the IRA. On the other hand, if you and your spouse are not covered by a retirement plan at work, the contribution will be fully deductible regardless of your AGI.

For 2010 and beyond, the \$100,000 modified AGI limit on converting a traditional IRA to a Roth IRA has been eliminated, so you can convert that 2009 traditional IRA

contribution to a Roth IRA in 2010 regardless of your AGI.

You must recognize the amount converted, except any basis, as income. However, any taxable income from a 2010 conversion will be included in gross income ratably over a two-year period beginning in 2011, unless you elect out of the two-year period and include all of it in 2010. This two-year rule only applies to 2010 conversions. Examine your tax situation to determine which year(s) to recognize any taxable income from a 2010 conversion.

Quick Tax Tips

1. You can deduct employment agency fees and amounts paid for preparing your resume while looking for a new job in your present occupation. You can also deduct the cost of traveling to and from an area if the trip is primarily to look for a new job. However, you cannot deduct job search expenses if you are looking for a job for the first time, or in a new occupation.
2. You can rent out your principal residence for a couple years before selling it and still exclude up to \$250,000 of gain (\$500,000 if married filing jointly) if you owned and used it as your principal residence for at least two out of five years ending on the date of sale. However, any gain due to depreciation and periods of nonqualified use must be recognized.
3. If you have an office in your home that is your principal place of business, you may deduct transportation expenses incurred in going between your home office and any other work location in the same trade or business.

Tax Developments

- The maximum IRA limit for 2010 is \$5,000 (\$6,000 if over age 50).
- The maximum Health Savings Account (H.S.A) limits for 2009 are \$3,000 if unmarried, and \$5,950 if married. If you were age 55 or older for the entire year the limits are \$4,000 and \$6,950, respectively.

Small Business Taxes

Employee or Independent Contractor? *Determining the proper worker status*

When you hire someone to work in your business, that individual will either be an employee or independent

contractor for tax purposes. Failure to properly classify the worker can subject you to an IRS audit and possibly interest and penalties for failing to withhold and deposit payroll taxes. Under common-law rules, if you have control over what work is being done and how it will be done, you are generally regarded as an employer and the worker is considered your employee.

The IRS uses three factors to determine the proper worker classification. Behavioral control refers to facts that show whether there is a right to direct or control how the worker does the work. Behavioral control looks at the type of instruction given, the degree of instruction, an evaluation system, and training.

The second factor is financial control. Financial control refers to facts that show whether or not the business has the right to control the economic aspects of the worker's job. Financial control factors consist of significant investment, unreimbursed expenses, opportunity for profit or loss, services available to the market, and method of payment. If you provide the tools and supplies to do the job, set the work hours, provide the location where the work is performed, and can hire or fire the worker, chances are this worker is classified as an employee. However, if the worker provides his own tools and supplies, performs services for an agreed price, performs these same services to others, and maintains control over how the work is completed, the worker is more likely an independent contractor.

The third factor is the type of relationship between you and the worker. Under type of relationship, take into consideration any written contracts, employee benefits, permanency of the relationship, and services provided as the key activity of the business. An employee will be hired for a long-term relationship and employee benefits will generally be provided.

You must weigh all of these factors when determining whether a worker is an employee or independent contractor. Some factors may indicate that the worker is an employee, while other factors indicate an independent contractor. The key is to look at the entire relationship you have with the worker, consider the degree or extent of the right to direct or control, and finally document each of the factors used in arriving at a determination.

If you are unsure whether your newly hired worker is an employee or independent contractor, you may file Form SS-8 with the IRS. They will assist you in making a proper determination, thus avoiding mistakes, audits, and additional taxes and penalties.

New Forms to Correct Employment Returns *Do you need to make an adjustment?*

The IRS has released the following new forms:

- Form 941-X, Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund, used to correct errors on Forms 941 and 941-SS. Form 941c can no longer be used.
- Form 943-X, Adjusted Employer's Annual Federal Tax Return for Agricultural Employees or Claim for Refund, used to correct errors on Form 943.
- Form 944-X, Adjusted Employer's Annual Federal Tax Return or Claim for Refund, used to correct errors on Forms 944 and 944-SS.
- Form 945-X, Adjusted Annual Return of Withheld Federal Income Tax or Claim for Refund, used for adjusting prior filed employment forms and to fix errors on Form 945.

Qualified Transportation Fringe Benefits *New bicycle commuting reimbursement for 2009*

The value of qualified transportation fringe benefits you pay to your employee is generally excluded from the employee's wages for 2009 up to certain limits. For commuter highway vehicle transportation and transit passes paid during January and February 2009, the limit is \$120 per month. The amount increased to \$230 a month on March 1, 2009. Qualified parking is \$230 per month. For each calendar year, \$20 multiplied by the number of qualified bicycle commuting months during the year is the qualified bicycling commuting reimbursement.

A qualified bicycle commuting month is defined as any month the employee regularly uses a bicycle for a substantial portion of the travel between the employee's residence and their work place. The employee cannot receive any other transportation fringe benefits during these months.

The employee can be reimbursed for the purchase of the bicycle and bicycle improvements, repairs, and storage. These expenses are considered reasonable as long as the bicycle is regularly used as transportation between the employee's residence and work place.

Employer-Provided Educational Assistance *Giving back to your employees*

You can provide your employees with tax-free education assistance by offering an educational assistance program. This allows you to provide up to \$5,250 for

tuition, fees, books, and supplies for classes without having to include the amount in an employee's wages. Both undergraduate and graduate level courses qualify for the assistance. The classes need not be job-related to qualify.

Choosing the §179 Expense Deduction ***Take advantage of year-end equipment purchases***

Each year, the IRS allows a business to write off the cost of purchased equipment. For 2009, the maximum amount allowed is \$250,000. The equipment can be purchased and placed in service at any time during the tax year. Even if you wait until the last day of the year to purchase and place in service a piece of equipment, you are allowed the full \$250,000 deduction.

The \$250,000 maximum is reduced dollar-for-dollar if your asset purchases exceed \$800,000. This means that if you purchase \$1,050,000 of eligible §179 properties during 2009, no deduction is allowed. Another limitation is that the §179 deduction cannot exceed your taxable business income. Business income includes the income from your trade or business plus wages received by you or your spouse, if married filing jointly.

Going Out of Business? ***Know the tax consequences before closing your doors***

You can close your business by selling all of the assets or converting the assets to personal use. The tax consequences of selling your business depend on whether you are operating a sole proprietorship or corporation. As a sole proprietor, if you sell all the assets of your business, you report the sale of each asset separately to determine the gain or loss. If you close your sole proprietorship business and keep all the assets to use personally, there may be some tax on recapture of depreciation.

When you want to end your corporate business, you can either sell the stock or the assets. If the assets are sold, the corporation pays the tax on any gain. As the shareholder, you don't have any tax consequences unless the corporation liquidates and distributes the proceeds to you in exchange for your stock. If the stock is sold, you report the sale of your corporate stock on your personal tax return.

If you take the assets out of the corporation, gain or loss is recognized on the liquidating distribution of assets as if the corporation sold the assets to you at fair market value. You, as the shareholder, do not have any tax consequences unless the fair market value of the assets distributed exceeds your stock basis.

As with any sales contract, it's important to determine the tax consequences before signing on the dotted line.

Health Savings Accounts (HSAs) ***What are the employer contribution limits for 2009?***

An HSA is a tax-exempt custodial account set up to pay or reimburse your medical expenses incurred during the year. The HSA is set up with a qualified HSA trustee. Eligible individuals must: (1) be covered under a high deductible health plan (HDHP) on the first day of the month, (2) have no other health coverage, (3) not be enrolled in Medicare, and (4) not be claimed as a dependent on someone else's tax return.

The amount that you can contribute to an HSA depends on your type of HDHP, age, and date of eligibility. The date you are no longer eligible must also be considered if applicable. Employers can contribute up to a specified dollar limit, which is exempt from federal income tax withholding, social security tax, Medicare tax, and FUTA tax. For 2009, the employer can contribute up to \$3,000 (\$4,000 if age 55 or older) if you have self-only coverage under a HDHP or up to \$5,905 (\$6,950 if age 55 or older) if you have family coverage under an HDHP.

Business Credits ***You could be eligible***

Business owners are eligible for a variety of tax credits. Here are a few credits you may qualify for:

- Alcohol Cellulosic Biofuel Fuels Credit. This credit varies depending on the alcohol proof percentage and the type of alcohol.
- Alternative Motor Vehicle Credit. This credit is available for certain new vehicles purchased and placed in service for business use during the tax year. There are five components to this credit.
 - Qualified fuel cell motor vehicle credit;
 - Advanced lean burn technology motor vehicle credit;
 - Qualified hybrid motor vehicle credit;
 - Qualified alternative fuel motor vehicle credit; and
 - Plug-in conversion credit.
- Alternative Fuel Vehicle Refueling Property Credit. This credit has been increased to 50 percent of the cost of qualifying property up to \$50,000 per location (\$200,000 for hydrogen).

- **Disabled Access Credit.** This credit amount equals 50 percent of the eligible access expenditures for the tax year between \$250 and \$10,250, with a maximum credit of \$5,000.
- **Employer Provided Child Care Credit.** Employers who provide in-house child care for their employees' children qualify for this credit. The credit cannot exceed \$150,000 for the year.
- **Small Employer Pension Plan Start-Up Cost Credit.** This 50-percent credit applies to the first \$1,000 in administrative expenses over the first three years to set up an employer pension plan and is limited to \$500 per year.
- **Tip Credit.** This credit is determined based on the federal minimum wage per hour rate. It is equal to 7.65 percent of the tips in excess of the amount needed to make up the minimum wage rate level. If the tip credit is claimed, the related social security taxes cannot be deducted.

Compensating an S Corporation Shareholder ***What is considered reasonable?***

If you are a corporate officer of an S corporation performing services for the corporation, you must pay yourself a reasonable salary. The IRS has not defined reasonable compensation in the code or regulations. However various courts have ruled on this issue based on the facts and circumstances of each case. Some of the factors the courts look at to determine reasonable compensation include training and experience, duties and responsibilities, time and effort devoted to the business, dividend history, payments to non-shareholder employees, timing and manner of paying bonuses to key people, what comparable businesses pay for similar services, compensation agreements, and the use of a formula to determine reasonable compensation. S corporations should not attempt to avoid paying employment taxes by having their officers treat their compensation as cash distributions, payments of personal expenses, and/or loans rather than as wages. The IRS could reclassify these amounts as compensation to the shareholder/employee resulting in additional taxes and penalties for the S corporation.

Keeping Good Records ***Why it's important for your business***

A business owner who keeps good records is able to easily monitor the progress of his or her business. Records can show whether the business is improving, what items are selling, or what changes may be necessary to make it more profitable. Keeping good

records can increase any business owner's chances of success.

Records are needed to prepare your financial statements. Income statements and balance sheets are used to prepare your income tax returns. Saving your receipts makes it easy to keep track of which expenses are business-related and which ones are not. Keeping good records also helps you to distinguish between taxable and nontaxable income.

Keeping track of expenses lessens the chance that you'll forget which expenses need to be deducted when it comes time to prepare your tax return. Any record that supports the information reported on your tax return is a record worth saving. If the IRS audits your tax return, having a complete set of records for the year in question will speed up the examination process.

Quick Tax Tips

1. The maximum depreciation deduction you can take for a truck or van used in business and first placed in service in 2009 is \$3,060 (\$11,060 for trucks and vans for which the special depreciation allowance applies).
2. Your employer contributions to a profit-sharing, SEP, or a SIMPLE plan are due by the time you file your tax return unless you have a valid extension. If your tax return is on extension, you have until the extended due date to make the contribution.
3. The maximum employee elective deferral amount for a §401(k) or §403(b) plan is \$16,500 for 2009.
4. Employers are required to issue W-2s to employees by January 31 of each year.
5. The standard mileage rate for business travel in 2009 is 55 cents per mile.
6. Are you giving gifts to your clients this holiday season? You are allowed a deduction for up to \$25 for each business-related gift.
7. The exclusion for gain on the sale of qualified small business stock has increased to 75 percent for stock acquired after February 17, 2009, and before 2011.