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2009 Fourth Quarter Federal Tax Developments

The start of 2010, and tax planning for the rest of 2010, has been shaped in several important ways by recent developments that took place just as 2009 drew to a close. Those fourth quarter 2009 tax developments should not be overlooked both in implementing 2009 return preparation strategies and in developing ways to immediately start lowering your 2010 tax bill. Here are those tax developments, as well as recommendations on how taxpayers affected by them should respond. As always, please give our office a call or send us an email if you have any questions about these developments.

Tax legislation. In November, Congress passed the Worker, Homeownership and Business Assistance Act. The new law provides all businesses with an expanded net operating loss (NOL) carryback and extends the first-time homebuyer credit. The House voted to extend the 2009 estate tax treatment to 2010, approved a jobs bill, and passed a package of extenders. However, the Senate did not act on any of these bills before its holiday recess. The Senate is expected to approve legislation that would retroactively extend the 2009 estate tax regime from January 1, 2010. Some of the "extenders" ---for example, x y z, are tax breaks that many individuals and businesses have taken for granted; they may be extended in 2010 retroactively to January 1, or Congress may be less generous based on tight budget deficits this year. Strategies to deal with both possibilities should be considered.

NOLs. The Worker, Homeownership and Business Assistance Act generally allows taxpayers to elect to carry back an NOL from 2008 or 2009 for three, four or five years. The IRS subsequently issued guidance. Decisions on how a business treats certain income and expenses on its 2009 tax year return now being prepared can make a difference in how effectively this NOL election can be utilized. Please contact our office for more details about this potentially valuable tax break, especially for businesses struggling during the recession.

Homebuyer credit. One of the most popular tax breaks in recent years is the first-time homebuyer credit. In November 2009, Congress extended the credit for qualified taxpayers purchasing principal residences on or before April 30, 2010. If a taxpayer enters into a binding contract before May 1, 2010 to close on the purchase of a principal residence before July 1, 2010, the new law treats the credit as not expiring until July 1, 2010. A reduced credit is available to qualified long-time homeowners who



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are buying replacement property. If you are thinking about buying -- or selling--- a home, integration of the homebuyer credit into those plans might mean the difference between closing a deal and being sidelined in this difficult market.

Retirement plans. The IRS had some good news for taxpayers in late 2009 when it announced that cost of living adjustments (COLAs) for qualified retirement plans in 2010 would be unchanged from 2009. There had been some concern that many of the figures would decrease in 2010 because of recent low inflation. Highlights include the 2010 limits on elective deferrals to 401(k)s, 403(b)s, certain 457s, and the federal government's Thrift Savings Plan remain unchanged at \$16,500. The limit on annual additions to defined contribution plans also remains unchanged at \$49,000 for 2010. Eligible individuals age 50 and above by the end of 2010 may make catch-up contributions to IRAs, 401(k)s and other savings arrangements. The catch-up amount for IRAs remains unchanged for 2010 at \$1,000. The catch-up amount for 401(k)s, 457s, 403(b)s, by eligible individuals age 50 and older also remains unchanged at \$5,500 for 2010.

Social Security wage base. Low inflation has contributed to no-change in the Social Security wage base for 2010, the IRS announced in October. The maximum amount of earnings subject to Social Security will be \$106,800 in 2010, which is unchanged from 2009. The so-called "nanny tax" also remains unchanged for 2010. Cash amounts paid for domestic services in the employer's private home are not subject to FICA taxes if less than \$1,700 during 2010.

Mortgage interest. In a pro-taxpayer interpretation of existing law, the IRS approved an interest deduction for an additional \$100,000 of a loan exceeding \$1 million that was used to purchase a residence. The IRS characterized the \$100,000 amount as home equity debt rather than as acquisition debt subject to a \$1 million limit under Code Sec. 163(h)(3). The decision effectively allows taxpayers to deduct interest on \$1.1 million of a loan used to purchase a residence, instead of the \$1 million loan limit on "acquisition indebtedness." Examining the Tax Code closely, the IRS concluded that the \$1 million limit was part of the definition of acquisition debt.

Mileage rates. Effective January 1, 2010, the standard business mileage rate falls from 55 cents per mile in 2009 to 50 cents per mile. The drop reflects low inflation in 2009 and lower gas prices. The standard mileage rate for medical and moving expenses for 2010 will be 16.5 cents-per-mile, also down from 2009. The rate for the charitable deduction remains fixed at 14 cents-per-mile for 2010.



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Per diem rates. The IRS reinforced the ability of businesses to streamline 2010 travel expense reporting for tax purposes when it issued its annual update of the "simplified per diem rates" this past October. The IRS-approved per diem rate for high-cost areas is \$258 (\$193 for lodging and \$65 for meals and incidental expenses), which represents an increase of \$2 from the previous rate. The IRS-approved per diem rate for all other areas is \$163 (\$111 for lodging and \$52 for meals and incidental expenses), which represents an increase of \$5 from the previous rate. The revised rates apply to per diem allowances paid for travel on or after October 1, 2009.

Overstatement of basis. The IRS issued temporary and proposed in late Fall to reinforce the agency's position that any basis overstatement, outside of a trade or business, which leads to an understatement of gross income under Code Sec. 61(a) is an omission from gross income for purposes of the extended assessment period (six years, instead of three) under Code Sections 6229(c)(2) and 6501(e)(1)(A). Several courts have issued contrary decisions. It is a development that needs to be watched by investors and other taxpayers that rely on basis calculations to compute their taxable gains.

Tax compliance. The IRS has been touting the success of its recent offshore disclosure initiative. According to top IRS officials, more than 14,000 taxpayers disclosed unreported foreign accounts. The IRS has started combing the disclosures for information about offshore tax evasion and has promised to continue its crackdown. One tool will be the IRS's new global higher-income industry group, which will focus on returns filed by high net worth individuals. Not only those who invest abroad but all taxpayers should take notice of the IRS across-the-board drive toward more frequent and aggressive audits as the agency is pressed by Congress to generate more revenues.

2010 filing season. Employers have been using revised withholding tables to implement the new Making Work Pay Credit. For some individuals, those revised withholding tables may have caused them to underpay their federal tax obligations for 2009. Lower refunds or even a balance due on 2009 tax returns will be a more frequent occurrence as a result. If you have questions about your withholding, please contact our office as soon as possible.

These are just some of a host of recent federal tax developments that need to be addressed by many taxpayers as early in 2010 as possible. Please contact our office if you have any questions about these or any tax developments.