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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 buyers 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; tax planning opportunities for trade-ins of business vehicles; 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.

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.

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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

The 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, 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, 4) extending the deadline for qualifying purchases to ***November 30, 2009,*** and 5) extending the credit for qualifying homes bought with proceeds from a tax-exempt mortgage revenue bond. **Planning Alert!** As we send this letter, there are proposals in Congress to extend this credit. **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. **Planning Alert!** If you purchased your home in 2009, you will have to pay back the credit if you sell your house or fail to use the house as your principal residence within 36 months after the date of purchase. However, the IRS website says that if you do not sell the house within 36 months but are sent on an extended military assignment within 36 months and plan to return to your house after the deployment, you will not have to pay back the credit.

- **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. **Tax Tip.** If you qualify and you are planning to marry someone who does not qualify, you can salvage the credit by buying your home *before you marry,* since your marital status is determined at the date you close on your home (i.e., title closing). This works even if you later marry in the same year. Also, 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.** If you constructed your qualifying home, your purchase *date* is the date you move in, even though the construction began earlier. In that case, be sure to *actually move in **before December 1, 2009.*** **Planning Alert!** Due to the refundable nature of this credit, IRS has reported that scammers have filed for the credit without actually buying a home. To minimize unnecessary IRS scrutiny, it might be wise to file a copy of your HUD-1 closing statement with your return if you are claiming this credit.

- **How Do The Credit Limits Apply?** For 2009 purchases, the amount of the credit is the lesser of: 1) $8,000 ($4,000 if you are married filing separately), or 2) 10% of the home's purchase price. 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.

- **It Is OK To Rent Out A Room.** IRS says the credit is allowed for a first-time home buyer who uses a dwelling as a principal residence and simultaneously rents out one or more rooms to tenants. **Tax Tip.** It appears that a qualifying college student who purchases a new home could rent a room to another student without jeopardizing the credit. **Planning Alert!** IRS says if you purchase a duplex and establish only one of the units as your principal residence, you may take the credit only for the purchase price allocable to that unit.

- **You May Buy Your First Home From Some Relatives – But Not Others.** Generally, you will not qualify for the credit if you purchase your first home from a "related party," which generally includes: your spouse, parent, grandparent, child or grandchild. **Tax Tip.** A "related party" **does not include** your brother, sister, aunt, or uncle. The IRS also says at its website that your step-relatives are not related parties.

- **If Purchase First Home In 2009, Consider Taking Credit On 2008 Return.** If you purchase your qualifying residence after 2008, and before December 1, 2009, you may elect to treat the purchase as made on December 31, 2008. **Tax Tip.** This election allows you to accelerate the tax benefit of the 2009 purchase by one year, and the election may be made on an amended 2008 income tax return. If you make this election, your income phase-out will be based on your 2008 income, even though your purchase actually occurred in 2009. Thus, you might get a larger credit by taking the credit on your 2008 return if your AGI is greater in 2009 than for 2008. Also, if you make this election for a 2009 purchase, you will still be exempt from the 2008 15-year recapture provisions. Instead, you will be subject to the 36-month recapture rule that applies to 2009 purchases.

- **Although Unmarried Co-Owners Get Only One Credit Per House–Allocation Is Flexible.** Two or more unmarried individuals who jointly purchase a dwelling and use it as their principal residence may each qualify for the credit. However, the total amount of the credit allowed to the individuals in the aggregate may not exceed the overall cap of $8,000 for 2009 ($7,500 for 2008). In addition, the IRS says that unmarried co-owners may allocate the credit between themselves in any reasonable manner. Thus, if one unmarried co-owner qualifies for the credit, but the other does not (e.g., due to AGI limits or previous home ownership within 3 years), the IRS says that you can allocate the entire credit to the co-owner who qualifies. The IRS website also suggests that this result will not change in a situation where both co-owners are jointly liable on the mortgage, even if only one of the co-owners makes the entire monthly payments on the mortgage.

- **Consider Having Low-Income Adult Child Co-Purchase Home With Parent.** These flexible rules offer nice planning opportunities for younger, lower income adults with wealthier parents or grandparents. For example, according to various statements in the IRS web site, it appears that the IRS would allow a young adult to co-purchase her first home with her parent, so long as the child cosigns the mortgage. It also appears that: 1) the parent could provide the entire down payment and co-sign the mortgage, and 2) the child and parent could then allocate the entire refundable credit to the qualifying child, even if the parent ends up making the mortgage payments.

- **You Also Get A Tax Break On The Property Taxes You Pay On Your New Home.** Even though buying your first-time home late in 2009 may not provide you enough 2009 property taxes and mortgage interest to itemize your deductions, you can still take the standard deduction for 2009. In that case, you may also claim a temporary *additional* standard deduction for state and local property taxes you paid on the new home in 2009 of up to $500 ($1,000 for joint filers).

It May Not Be Too Late To Take Advantage Of 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. **Planning Alert!** Please call us as soon as possible if you think that your current tax withholdings or estimated tax payments may not meet one of these safe harbors. If so, we may be able to solve the problem by having you withhold additional taxes from your 2009 year-end bonus, or from a distribution from your IRA, etc. Any income tax withholding (including withholdings at the end of 2009) is deemed paid timely throughout the year. Therefore, amounts withheld **on or before December 31, 2009** that allow you to satisfy one of the exceptions described above may eliminate your penalty for underpaying estimated taxes. **Tax Tip.** Even if you fail the safe harbors based on your prior year's *2008 taxes* described above, all may not be lost. You can still avoid the penalty if you paid at least 90% of your *current 2009 taxes* either through timely estimated quarterly tax payments, or through withholding. Thus, even if your estimated taxes for 2009 are substantially lower than your 2008 tax, it is possible to satisfy this 90% of *current* year taxes safe harbor where: your 2009 income has dropped off substantially; you incurred much larger deductions in 2009; or you qualify for some of the recent tax credits in 2009.

Cash For Clunkers **Is Gone – But You May Still Get A** ***Sales Tax Deduction*** **On A New Car.** 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). **For example,** assume that in 2009 you are single with MAGI under $125,000, you purchase a new sedan for $60,000, and you also pay a 5% sales tax of $3,000. For 2009, you should be allowed either an *itemized deduction* or an *additional standard deduction* of $2,475 ($49,500 x 5%). **Tax Tip.** The IRS has indicated that if you purchase more than one vehicle qualifying for the sales tax deduction, you may deduct the taxes paid on *each vehicle.* Also, this new car sales tax additional standard deduction (or itemized deduction) is deductible for AMT purposes. **Planning Alert!** If you itemize deductions, you are allowed to deduct sales taxes paid on qualified vehicle purchases *in addition to* your state and local income taxes. However, if you *elect* to deduct all of your sales taxes (including the qualified motor vehicle tax) in lieu of state and local income taxes, this new provision will not provide an additional deduction. **Planning Alert!** If you purchase a vehicle in a state without a sales tax, IRS says that you may claim this deduction for the amount of other fees or taxes imposed by your state or local government, provided that the fees are based on the vehicle's sales price or as a per unit fee.

The 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 example, in 2008 you were entitled to a HOPE credit of up to $1,800 per student for qualified tuition and fees paid for yourself, your spouse, or a dependent. However, this credit phased out as your modified adjusted gross income increased from **$96,000 to $116,000** on a joint return **($48,000 to $58,000** on a single return).The *2009 Act* changes the name of the HOPE credit to the ***"American Opportunity Tax Credit"*** **for 2009 and 2010,** and makes five significant changes to the credit for those two years: **1) Amount of Credit** – the maximum credit is increased from $1,800 to $2,500 (100% of the ^{1St} 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).*

- **Tax Tip.** Even if a student is subject to the "kiddie tax," he or she can still claim the credit; however, none of the credit would be "refundable" (i.e., the student could benefit only to the extent she otherwise would have had a tax liability). Also, if your income is too high to qualify for the credit, the IRS says the student (e.g., your child) may claim the credit on his or her return, provided you do not claim that child as a dependent on your tax return (even if the child otherwise qualifies as your dependent). **Caution!** Be sure to check with your health insurance carrier before foregoing the dependency exemption for your child. It is possible that failing to claim the exemption will impair your child's health insurance coverage under your health plan. We will be glad to help you decide whether this planning technique is right for you and your family.

"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).** Also, the credit is not available if you qualify as someone's dependent, or if you are a nonresident alien. 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. **Planning Alert!** Since the credit is built into the withholding tables, this may result in the amount of Federal income tax withholding for 2009 being less than your actual 2009 taxes. This becomes increasingly likely if both you and your spouse are employed forcing your combined income above the phase-out levels, or you are carrying two jobs and both employers are reducing your withheld taxes by the credit. These reduced withholding amounts could actually cause you to underpay your required 2009 taxes, and trigger an underpayment penalty for 2009. **Please call** our firm if you think that you may be in this situation, and we will help you determine whether you need to increase your 2009 year-end withholdings to avoid a penalty.

One-Time $250 "Economic Recovery Payment" To Certain Veterans, Social Security Recipients, Etc.
Generally, if you receive social security retirement or social security disability benefits; veteran's compensation or veteran's pension benefits; Railroad Retirement benefits; or Supplemental Security Income (SSI) benefits (excluding individuals who receive SSI while in a Medicaid institution); you probably have received a **one-time payment** of $250 (which will **not** be treated as taxable income). If you also qualify for the "Making Work Pay Credit" (discussed above), that credit is reduced by this $250 Economic Recovery payment you receive.

2009 Refundable Credit For Government Retirees. If you are a government retiree and **during 2009** you received a pension or annuity for service performed in the employ of the U.S. or any state, and you do not receive an "Economic Recovery Payment" (discussed above), you may be entitled to a *refundable* credit on your 2009 return. The credit is $250 ($500 if you file a joint return and both you and your spouse are eligible individuals). If you also qualify for the "Making Work Pay Credit" (discussed above), that credit is reduced by this $250 credit you receive under this provision.

Don't Overlook 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. These credits include:

- **Up To $1,500 Credit For Qualified Energy-Efficient Home Improvements.** For improvements to your *principal residence located in the U. S.* **and placed in service in 2009 and 2010,** the *2009 Act* provides a 30% credit for qualified expenditures with a $1,500 maximum cumulative credit for the 2009 and 2010 tax years (previously, there was a lifetime credit limit of $500). Also, the credit is allowed even if the

improvements are purchased with government subsidized energy financing. Qualified improvements can include *properly certified* energy efficient roofs, insulation, exterior windows (including skylights), exterior doors, heat pumps, hot water boilers and air conditioners. **Tax Tip.** If you used all or part of the $500 lifetime credit limitation prior to 2009, this will not reduce your $1,500 aggregate limit for 2009 and 2010. **Planning Alert!** This credit is limited to qualifying improvements to your "principal residence" located in the U.S. (improvements to second homes do not qualify). Also, although *installation costs* for qualifying heat pumps, hot water boilers, and air conditioners qualify for the credit, the installation costs for qualifying insulation, windows, roofs, and doors do not. Before making energy-efficient improvements to your home, you should first check to see if the manufacturer has certified the products as qualifying for the energy tax credit. You can also go to www.energystar.gov and type in "energy credits" for detailed information on whether your planned improvements qualify for the credit. **Caution!** The credit was not allowed for 2008!

- **30% Credit For Qualified *Residential* Solar Water Heaters, Geothermal Heat Pumps, Wind Energy Property, And Solar Electric Generating Property.** If you install a qualifying solar water heater, solar electric generating property, geothermal heat pump, or small wind energy property in your residence located in the U.S., you may qualify for a credit equal to 30% of the equipment's cost (including onsite labor costs). **The residence need not be your "principal residence,"** so installations in your second residence or vacation home may qualify. Before 2009, this credit was capped at $2,000 for solar water heaters, solar electric generating property, and geothermal heat pumps. For **qualifying property placed in service after 2008,** these dollar caps are removed. Also, the credit will now offset the alternative minimum tax as well as regular tax. So, for example, if after 2008, you place a qualifying solar water heater in service that cost $10,000, you would be entitled to a full 30% credit of $3,000 with no overall dollar cap. Also, under the new legislation, the credit is allowed even if the improvements are purchased with government subsidized energy financing. **Tax Tip.** The IRS says on its website that this credit is available to the extent that the purchase price of a new home can be reasonably allocated to the qualifying energy-efficient equipment. So, if you purchased a new home in 2009, be sure to ask the builder to provide you a cost breakdown of any solar electric panels, solar water heaters, etc. **Planning Alert!** Expenditures related to swimming pools or hot tubs (e.g., solar equipment to heat water or run electrical pumps) do not qualify.

Starting In 2009, The Hybrid Vehicle Credit Is Allowed Against The Alternative Minimum Tax (AMT). If you buy a qualified hybrid vehicle, you may be entitled to a tax credit. This credit begins phasing out for manufacturers once they produce over 60,000 energy-efficient vehicles. Due to these phase-out rules, vehicles manufactured by Toyota and Honda no longer qualify for the credit, and the credit for Ford hybrid vehicles began phasing out for vehicles **purchased after March 31, 2009.** However, qualifying vehicles manufactured by other companies (e.g., GM, Chrysler, Mazda, Nissan) still qualify fully. **Starting in 2009,** this credit is allowed against AMT. **Tax Tip.** You can get an updated list of the credit status of all hybrid vehicles by visiting the IRS website at www.IRS.gov and typing in "hybrid cars and alternative fuel vehicles."

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%, 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. **Planning Alert!** Unfortunately, this waiver does not apply to any RMDs that you were required to take in 2008. So, **if you reached age 70% during 2008,** and did not take your first RMD in 2008, you were still generally be required to take your first RMD **no later than April 1, 2009** to avoid the 50% penalty for failing to make a required distribution. In that situation, your second RMD must be made no later than **December 31, 2010.** On the other hand, **if you reach age 70% in 2009,** you have **until December 31, 2010** (rather than April 1, 2010) to take your first required distribution. If you have already received a payment in 2009 that was not required, you may keep it without penalty and simply include it in your taxable income. If you do not want to keep it and include the distribution in income, you normally are required to roll the amount distributed into an IRA **within 60 days of receipt,** in order to avoid taxation of the distribution. The IRS recently announced that it will waive the 60-day requirement if you complete the rollover **no later than November 30, 2009. Tax Tip.** Rolling the distribution over may be particularly helpful if you want to keep your taxable income below the income

thresholds necessary to take advantage of other 2009 tax breaks discussed in this letter. **Planning Alert!** The IRS also reminded us in its recent announcement that only one rollover from one IRA to another may be made within a 12-month period. **Please call us** if you wish to roll these amounts to an IRA so we can assist you with the transaction.

Increase In Earned Income Tax Credit (EITC). For **2009 and 2010,** the *2009 Act* generally enhances the EITC for taxpayers with three or more qualifying children.

Enhanced Refundable Portion Of Child Credit. The $1,000 child tax credit is one of the most popular tax breaks for low and middle income taxpayers. For **2009 and 2010,** the *2009 Act* makes it easier for individuals to qualify for the *refundable* child credit. For 2009 and 2010, the child tax credit is refundable to the extent of 15% of an individual's earned income in excess of $3,000 (previously $8,500). For example, **in 2008,** a qualifying taxpayer with one child under age 17 would have needed earned income of **at least $15,167** for the entire $1,000 child credit to be *refundable* (i.e., refunded to the individual even if the credit exceeds tax liability). **For 2009 and 2010,** the same individual could have earned income **as low as $9,667** and still be entitled to the entire refundable $1,000 child credit.

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.

Section 529 Plans. For **2009 and 2010,** the *2009 Act* allows certain computer technology or equipment, internet access, and related services to be paid from a section 529 plan (in addition to tuition, fees, books, supplies, etc.) without triggering income. **Tax Tip.** Because of recent stock market volatility, the IRS announced that it will generally allow you to change your investment strategy in your §529 plan, for **calendar year 2009 only,** one more time even if you previously changed it for that same plan in 2009. Normally, you are allowed to change your investment fund strategy in a §529 plan only once per calendar year. This is particularly helpful if you feel that the investment fund you chose earlier in 2009 should be changed due to more recent market developments.

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"** in the tax year **ending in 2008** (or, instead at the taxpayer's election, in the **tax year beginning in 2008),** taxpayers may "elect" an extended NOL carry back period from 2 years to up to 5 years. In other words, **a qualifying business may "elect" a 3, 4, or 5-year carry back period for a qualifying 2008 NOL. Planning Alert!** If the *eligible small business* generating the loss is a pass through entity such as an S corporation, a partnership, or a proprietorship, the loss flows through to the owners, and the owners determine if they have an NOL. If so, the owners (not the pass through entity) may elect the extended carryback period for the portion of the NOL passing through from the eligible small business. In other words, the election for "pass through" businesses is made by the owners on the owner's returns.

- **Due Date For Election.** The election to utilize the extended carryback period for a tax year ending in 2008 must be made no later than six months after the due date of the tax return (excluding extensions) for the year of the NOL. **Therefore, the latest date that an election to utilize the extended carryback period** for a 2008 calendar-year taxpayer **was either September 15, 2009 or October 15, 2009 (six months after the due date of the tax return, excluding extensions).** For example, a calendar-year C corporation was required to make the election for the 2008 tax year no later than September 15, 2009, and a calendar-year individual was required to make the election no later than October 15, 2009. **However, 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.** The election to utilize the extended carryback period for a fiscal year *beginning* in 2008 **must be made by the due date of the return for that year (including extensions).**

- **Eligible Small Business.** To make the election, the loss must have been generated by an "eligible small business." Generally, an **"eligible small business"** is *a* corporation, partnership, or sole proprietorship that has generated average gross receipts of no more than $15 million for the 3 tax years (or, shorter period of existence) ending with the tax year of the NOL. **Tax Tip.** 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), please call our office. We will help you determine whether or not you should elect **an** extended carryback period. In addition, if you choose to carry the loss back, there are steps that you can take to speed up your tax refund such as filing Form 1139 rather than amending prior year returns.

Increased $250,000 Section 179 Deduction Extended Through 2009. Last year, the *Economic Stimulus Act of 2008* 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.** Prior to these temporary increases, the §179 deduction was reduced by the amount of your §179 property acquisitions in excess of $500,000. For **2008 and 2009,** the phase-out threshold has been increased to $800,000. 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.** Generally, "placed in service" means the property is ready and available for use. Therefore, to be safe, qualifying property acquired by calendar-year businesses should be set up and tested **before 2010** to ensure the higher $250,000 limits will apply. **Planning Alert!** For tax years beginning after 2009, the §179 deduction is scheduled to drop back down to $134,000. **Tax Tip.** If you are considering a significant equipment or business vehicle purchase, please call our office. We will help you develop a purchase strategy that gives you maximum depreciation deductions.

- **Planning Alert!** If you have a pass-through business entity (e.g., S corporation, LLC, partnership), you must apply the $250,000/$800,000 limitations twice–once at the entity level and again to the owners (i.e., to the S Corporation Shareholders, LLC Members, and Partners). In certain situations with fiscal-year pass-through entities, the $250,000/$800,000 limitations may be reduced. If you own an interest in a fiscal-year pass-through entity and plan to take advantage of these temporary increases in the §179 deduction limitations, please call our firm. We will help you maximize your section 179 deduction.

- **Tax Tip.** The §179 deduction generally is not allowed to the extent the deduction exceeds the taxpayer's business taxable income (as determined without the § 179 deduction). Thus, the §179 deduction generally cannot create a taxable loss (or NOL). For pass-through entities, this so-called *taxable income limitation* is applied at both the entity level, and again at the owner level. However, if wages are paid to 2% (or more) S corporation shareholders or "guaranteed payments" are paid to owners of a partnership, the S corporation or partnership §179 deduction can actually exceed the pass-through entity's *taxable income,* and create a pass-through loss.

The 50% Bonus Depreciation Also Extended Through 2009. The original bonus depreciation was first allowed following the terrorist attacks of 2001 and generally sunset after 2004. 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. Planning Alert!** Remember, 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.** Also, the §179 deduction (discussed above) must be taken before the 50% bonus depreciation. **Tax Tip.** There is no AMT impact with respect to 50% bonus depreciation property unless the taxpayer elects not to take the 50% bonus depreciation. Also, the §179 deduction and the 50% bonus depreciation deduction are not prorated if the property is placed in service at the end of 2009.

- **Qualifying 50% Bonus Depreciation Property.** Generally, the 50% bonus depreciation deduction applies only to *new* 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!** These are only *examples* of qualifying property. If you have a question about property that we have not mentioned, call us and we'll help you determine if it qualifies.

- **Tax Tip.** Make sure you properly classify "land improvements" as "15-year property' (and not as part of the building) since land improvements qualify for the 50% bonus depreciation, and buildings generally do not. Furthermore, property within a new building that is not a structural component of the building (e.g., pursuant to a *cost segregation study) may* be treated as "tangible personal property." If you can effectively segregate these costs, you may qualify for three favorable depreciation benefits: 1) §179 treatment, 2) the 50% bonus depreciation deduction, **and 3)** more rapid MACRS depreciation write-offs.

- **Tax Tip.** Unlike the §179 deduction, the 50% bonus depreciation has no "taxable income" limitation and, therefore, can create or add to a net operating loss (NOL). If you have a qualifying fiscal year business that has not made the election to use the temporary 5-year NOL carry back period for the *tax year ending in 2008,* you may still have the option to make the temporary 5-year NOL carry back election for the *tax year beginning in 2008.* In that event, if your fiscal year business anticipates a loss for the tax year beginning in 2008, but has generated healthy profits within the past 5 years, it may be prudent to take the 50% bonus depreciation deduction for qualifying purchases **made by December 31, 2009.** This would increase the 2009 NOL, which might allow you to recoup more prior year taxes due to the temporary 5-year carry back period. Please call our firm and we will gladly help you determine whether taking full advantage of the 50% bonus depreciation for 2009 will save you and your business taxes.

- **Corporations May Swap 50% Bonus Depreciation For "Refundable" AMT And R&D Credits.** Corporations currently incurring losses may receive minimal tax benefit from the 50% bonus depreciation. However, corporations may elect to treat up to 6% of unused alternative minimum tax (AMT) and research and development (R&D) credits attributable to tax years **beginning before 2006** as refundable credits. The *2009 Act* extended the sunset date for this provision from 2008 **through 2009. Consequently, if this election is made 1)** the bonus depreciation deduction **does not apply to qualifying property acquired and placed-in-service after March 31, 2008, and before 2010,** and 2) the corporation must use the **straight-line** depreciation **method for all assets otherwise qualifying for bonus depreciation and placed-in-service after March 31, 2008 and before 2010. Tax Tip.** If your corporation currently has unused AMT and/or R&D credits and also has existing net operating losses, this election may be beneficial. **Planning Alert!** These rules are complex and it will require a detailed analysis to determine whether your corporation could benefit from this election. We will gladly assist you with this analysis.

Bonus Depreciation For Passenger Automobiles. The maximum annual depreciation deduction (including the maximum §179 deduction) for most *business automobiles* is capped at certain dollar amounts. **For 2009,** the maximum first-year depreciation for a business automobile is generally capped at $2,960 ($3,060 for trucks and vans not weighing over 6,000 lbs). However, the *2008 Stimulus Act* increased the first-year depreciation cap by $8,000 for autos qualifying for the 50% bonus depreciation in 2008. The *2009 Act* **extends this $8,000 increase through 2009. For example,** let's say you are self employed and you are planning to purchase a *new* vehicle weighing 6,000 lbs or less that will be used 100% in your business. If you buy the vehicle and place it in service before the end of 2009, your first-year depreciation deduction will be $10,960. If you wait until 2010 (assuming Congress doesn't extend bonus depreciation and the 2010 first-year depreciation cap is the same as for 2009), your first-year depreciation deduction would be only $2,960. **Planning Alert!** The dollar limits must be reduced proportionately if your business use of a vehicle is less than 100%. For example, assume you are self-employed and you buy a new $30,000 passenger vehicle which you use 60% for business and 40% for personal driving in the first year. Your first year depreciation dollar

limit for 2009 would be $6,576 ($10,960 x 60%). **Caution.** If you wait until early 2010 to purchase the same vehicle and the first year cap is the same for 2010 as for 2009, your first year limit would be only $1,776

($2,960 x 60%). **Tax Tip.** If you purchase the passenger vehicle late in 2009, be sure to use it as much as possible for business through **December 31, 2009,** and keep your personal use to a minimum. This will maximize your business percentage for 2009, and could dramatically increase your 2009 depreciation deduction. **Planning Alert!** If you take additional $8,000 first year depreciation deduction on your passenger vehicle purchased in 2009, and your business use percentage later drops to 50% or below, you may be required to bring into income a significant portion of the depreciation taken. Therefore, it is imperative that the business use of the vehicle exceeds 50% for subsequent years.

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). For example, for a *new* SUV weighing over 6,000 lbs used entirely for business and placed-in-service in 2008 or 2009: 1) up to $25,000 of the cost can be deducted immediately under section 179, 2) 50% of the remaining balance can be claimed as bonus depreciation, and 3) 20% of what's left can generally be taken as regular MACRS depreciation for the first year. Thus, for a $50,000 new qualifying SUV placed in service in 2009, $40,000 could generally be written off in 2009 (assuming 100% business use). 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. **Planning Alert!** As pointed out with regard to business vehicles in the previous segment, if you take the §179 deduction and/or the 50% bonus depreciation deduction on an SUV or truck weighing over 6,000 lbs, and your business use percentage later drops to 50% or below, you may be required to bring into income a significant portion of the depreciation taken in previous years. Therefore, you should make sure that the business use of the vehicle exceeds 50% for subsequent years.

Your Business Has New Incentives To Hire "Unemployed Veterans" And "Disconnected Youth." If your business 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*. **"Unemployed veterans"** are generally individuals who have been discharged or released from active duty (after having served for more than 180 days) in the U.S. Armed Forces at any time during the 5-year period ending on the hiring date, and received unemployment compensation for at least 4 weeks during the 1-year period ending on the hiring date. **"Disconnected youth"** are generally unskilled individuals from age 16 through age 24, who have not been regularly employed or attended school in the 6 months preceding the hiring date and, in certain situations, have not earned a high school diploma or a G.E.D. **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.

S Corp 10-Year Built-In Gain Period Temporarily Shortened To 7 Years. If a regular "C" corporation elects "S" corporation status (a "Converted S Corporation"), the election itself generally creates no immediate taxation. However, the Converted S Corporation must generally pay a 35% corporate "built-in gains tax" on the sale of any built-in gain asset, if sold during the first 10 years following the S election ("10-Year Recognition Period"). A *built-in gain* asset is generally any asset with a market value greater than the asset's basis on the effective date of the S election. This built-in gains tax can also be triggered by an income recognition event other than a *sale*. For example, the collection of accounts receivables, which arose before the S election, by a cash-basis S corporation can trigger the tax. For built-in gains recognized in **tax years beginning in 2009 or 2010,** the *2009 Act temporarily* reduces the 10-Year Recognition Period to 7 years. For example, if a Converted S Corporation sells a built-in gain asset during its tax year **beginning in 2009,** there will generally be no *built-in gains tax* if the S election was **first effective for 2002, or earlier.** This gives S corporations the opportunity to sell built-in gain assets up to three years earlier than under prior law without paying the 35% built-in gains tax.

"Qualified Small Business Stock" Exclusion *Temporarily* Increased From 50% To 75%. If you sell "qualified small business stock" acquired prior to February 18, 2009, you can exclude 50% of the gain from your gross income. The remaining 50% of the gain is taxed at a maximum rate of 28%. Therefore, the maximum regular Federal tax rate is 14%. *Qualified small business stock* (QSBS) is generally stock of a C corporation engaged in a qualifying business, issued after August 10, 1993, held for more than 5 years, where the issuing corporation meets certain active business requirements and owned assets at the time the stock is issued of $50 million or less. The *2009 Act* provides that for QSBS **acquired after February 17, 2009 and before 2011,** the 50% exclusion is increased to 75%. Therefore, the maximum regular Federal tax rate upon a sale of this stock after holding it for more than 5 years will be 7%. **Planning Alert!** Remember, QSBS does not qualify for any gain exclusion unless it first satisfies a 5-year holding period. Thus, taxpayers who **acquire qualifying stock after February 17, 2009 through December 31, 2010,** must still hold the stock for more than 5 years to qualify for the 75% gain exclusion.

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). An election to defer the recognition of COD income is made with the income tax return for the tax year in which the debt instrument is reacquired, renegotiated, or forgiven. **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. **Planning Alert!** As under prior law, a discharge of indebtedness doesn't give rise to gross income if it: 1) occurs in a Title 11 bankruptcy case; 2) occurs when the taxpayer is insolvent; 3) is a discharge of "qualified farm indebtedness"; 4) is a discharge of "qualified real property business indebtedness"; **or 5)** is a discharge of up to $2 million of home acquisition mortgage debt on the taxpayer's principal residence. Where these exclusions apply, taxpayers generally reduce certain tax attributes, including loss and credit carryovers and basis in property, by the amount of the excluded income.

2009 TAX DEVELOPMENTS *OTHER THAN NEW LEGISLATION*

Tax Developments Impacting Primarily *Individual* Taxpayers–Selected 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," in effect designated his estate as the beneficiary of his IRA. Therefore, the balance in the IRA had to be distributed and taxed by the end of the fifth year following the decedent's death. If, instead, the decedent had named the individual beneficiaries of his estate as the direct beneficiaries of his IRA in the beneficiary designation form, the IRA could have been distributed and taxed over a period at least as long as the life expectancy of the oldest beneficiary. By making this common mistake, the beneficiaries lost a significant tax deferral opportunity. **Planning Alert!** Generally, in order to postpone distributions from retirement plans as long as possible after death (and thereby postpone the tax), you should name individuals or qualifying trusts as your beneficiaries. Naming your estate as the beneficiary generally results in the least deferral and the least planning opportunities. **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.

Beware Of Tax Trap When Supporting Children Of "Significant Others." A recent IRS Announcement and a Tax Court case each addressed the situation where unmarried couples live together and one individual

has little or no taxable income and has a child, but the other individual (i.e., the taxpayer) supports that child. In this case, although the taxpayer may possibly be able to claim the partner's child for purposes of the "dependency exemption" (as a "qualifying relative"), he or she will generally not be entitled to use the partner's child to claim *head of household, child care credit, child tax credit,* or the *earned income tax credit.* **Tax Tip.** When and if the couple marries, these listed tax benefits would be available to the supporting spouse who otherwise qualifies.

Starting In 2009, Divorced Or Separated Parents Must Satisfy 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); 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); and **4) a revised and newly-released Form 8332** (revised February, 2009) containing instructions regarding the new rules, and a new section for a custodial parent to revoke a previous assignment of a dependency exemption to the noncustodial parent. **Tax Tip.** If you are the custodial parent and you have previously waived your child's exemption, you can retract that waiver for 2010 provided that you properly execute the new Form 8332, and give necessary notice to the other parent **before 2010. 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 Madoffs 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 a 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 Tip.** If you are considering year-end gifts to take advantage of the $13,000 annual gift tax exclusion for 2009, the IRS says that your donee must **actually *deposit* the check by December 31, 2009** to count as a 2009 gift. Otherwise, it will be treated as a 2010 gift.

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.

IRS Identifies Potential Tax Trap When Trading In Business Vehicles. When buying a new vehicle, it is not unusual for a business to "trade in" an old business vehicle for the new one. A recent IRS release reminds us that this seemingly simple transaction can result in a tax trap. In this ruling, the IRS generally concluded that cars, light general purpose trucks, crossovers, sport utility vehicles, minivans, and cargo vans are "like-kind" property for purposes of §1031 like-kind exchanges. Therefore, a trade in of one of these business vehicles for any other from that group, constitutes a tax-deferred (§1031) like-kind exchange. Consequently, if you trade in one of the vehicles listed above (weighing 6,000 lbs or less) used in a business for another vehicle listed above (weighing 6,000 lbs or less), this ruling usually works against you. In that situation, the vehicle will likely have a built-in loss due to the limited depreciation deductions imposed on most vehicles weighing 6,000 lbs or less. Since §1031 is mandatory and not elective, the trade defers the loss on the trade in vehicle. In this situation, it would generally be better for you to avoid the trade in and, instead, sell the old vehicle. By selling the vehicle, you could deduct the loss and use the sales proceeds to purchase the new business vehicle. **Planning Alert!** Where one vehicle is traded in for another, some states charge sales tax only on the cash paid in the trade. If this is the case in your state, selling the old vehicle and buying the new one could result in additional sales taxes compared to a trade in. **Tax Tip.** This ruling would likely benefit your business if it exchanges a business truck or SUV weighing over 6,000 lbs for another business vehicle. In that situation, it is likely that the truck or SUV that you are trading in would have a significant built-in gain due to large depreciation deductions, and the trade in would defer that gain.

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 "limited 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. This is often recommended 1) to help protect the leased facility from potential claims of the corporation's creditors, and 2) to avoid the potential of generating a double tax (at both the corporate and shareholder levels) when the building is sold. However, a recent Tax Court case reminds us that this planning technique 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. If you are involved in leasing property to your corporation, please call our firm. We will help you structure the lease agreement to your maximum tax advantage.

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 including: 1) when during the tax year the payment is made, 2) whether the loan is an "open account" advance, or evidenced by a written promissory note, and 3) the amount of the unpaid balance on an "open account" advance as of the end of the tax year. **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.** If you have loaned funds to your S corporation in order to take losses flowing through from the S corporation, your outstanding loans have a tax basis less than the face amount of the debt. Therefore, any payment of that debt will likely generate taxable gain to you. 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.

IRS Warns That A Partnership's Distribution Of Borrowed Funds May Trigger Taxable Gain. Often, direct owners of appreciated real estate borrow against the equity in the property, and use the loan proceeds for purposes unrelated to the real estate that serves as security for the loan. These types of loan transactions rarely create any taxable gain to the owners. However, if the appreciated real estate is owned by a limited liability company (LLC) or limited partnership, a distribution of loan proceeds to limited partners can, in certain situations, trigger gain to the limited partners or LLC members. In a recent release, the IRS was asked to review a transaction where a lender made a recourse loan to a limited partnership. After receiving the loan proceeds, the partnership distributed those borrowed funds to its partners in proportion to their ownership interests in the partnership. The IRS concluded that the limited partners had a *taxable gain* when the borrowed funds were distributed because the distribution exceeded the bases in their partnership interest. **Planning Alert!** This IRS release illustrates the risks involved with a partnership or LLC borrowing money and distributing the loan proceeds to the partners or members based solely on each partner's ownership interest percentage. **The gain in this case was triggered because the limited partners were not liable for the loan made to the partnership and therefore did not receive an increase in the basis of their partnership interests. Tax Tip.** *If* your partnership or LLC is planning to borrow funds in order to distribute those funds to the owners, please be careful. Gain will be triggered if the distribution exceeds a partner's basis in his or her interest in the partnership.

Beginning Business Operations Quickly Accelerates Deductions For "Pre-Opening" Expenses. If you are planning to open a new business, you are generally not allowed to deduct any of your business expenses unless and until your new business begins operations. Once your new business opens, subject to certain phase-out limits, you can generally deduct immediately up to: 1) $5,000 of your "start-up expenses" (e.g., pre-opening professional fees, filing fees, travel, advertising, supplies, employee training expenses-including wages), plus 2) an additional $5,000 of your "organizational expenses" (e.g., expenses related to establishing your corporation, partnership, or limited liability company). Your *start-up expenses* and *organization expenses* in excess of $5,000 each may be deducted pro rata over 15 years after your business starts. **Note!** If either your total *start-up expenses* or your total *organization expenses* **exceeds $55,000,** the $5,000 up-front deduction is not available. Instead, the entire expenses must **be amortized over 15 years. Planning Alert!** Opening your business quickly accelerates your deductions for *start-up expenses* and *organization expenses.* Also, beginning your business operations as soon as possible accelerates your ability to deduct your ongoing business expenses immediately as *operating expenses*, instead of *start-up expenses.* In a recent case, the Tax Court stated that a "taxpayer is not *carrying on a* trade or business .... until the business is functioning as a going concern and performing the activities for which it was organized." **Tax Tip.** If you are in the process of starting a new business and wish to accelerate these deductions, you should take steps as early in the process as possible to establish that your business has actually begun operations (e.g., offer the operations to the public, engage a client or customer, open your doors for business).

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. Please call us before implementing any planning ideas discussed in this letter, or if you need additional information. **Note:** 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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