

ROBINSON, FARMER, COX ASSOCIATES

CERTIFIED PUBLIC ACCOUNTANTS

A PROFESSIONAL LIMITED LIABILITY COMPANY

2009 NEW TAX LAW LETTER

There have been significant tax developments in 2009 including the *American Recovery and Reinvestment Tax Act*, 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; 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.**

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. 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.

On November 6, 2009, President Obama signed the “**The Worker, Home Ownership, and Business Assistance Act of 2009**” (*WHBA 2009*), which *substantially expands* the widely popular home buyer’s refundable tax credit by: extending it to contracts signed by April 30, 2010 (if closed by June 30, 2010); substantially increasing the income phase-out levels; expanding the credit to certain long-term homeowners; and liberalizing the rules for certain military personnel. In addition, *WHBA 2009* opens up new opportunities for many businesses (regardless of size) that incurred tax losses (net operating losses) in 2008 and/or 2009, to recoup all or a portion of the taxes paid in previous profitable years as far back as five years.

Recent Tax Legislation

NEW TAX BREAKS AVAILABLE TO INDIVIDUAL TAXPAYERS - SELECTED PROVISIONS

Expanded Home Buyer’s Credit Offers New Tax Planning Opportunities

In 2008, Congress enacted its initial version of the *first-time* home buyer’s tax credit and, in early 2009, expanded and extended the credit. Now, Congress has once again extended the credit and expanded it even to certain taxpayers who are **not first-time** home buyers. Consequently, we now have three different versions of this increasingly popular tax credit. The version that applies depends on the date the taxpayer bought the home. For example, if you were a qualifying taxpayer who purchased your *first-time* home **on or before December 31, 2008**, you qualified for a *refundable* credit of up to \$7,500 that is required to be paid back to the government in equal installments over 15 years, or earlier if the house is sold or you fail to use the home

- CHARLOTTESVILLE - RICHMOND - FREDERICKSBURG - VERONA - CHRISTIANSBURG -

P.O. BOX 6580 CHARLOTTESVILLE, VIRGINIA 22906

E-MAIL: rfa@rfca.com INTERNET: www.rfca.com TELEPHONE: 434-973-8314 FAX: 434-974-7363

as your principal residence. **Caution!** These rules continue to apply to qualifying home purchases **before 2009** (including the 15-year payback requirement). On the other hand, if you were a **qualifying first-time home buyer who purchased your home after 2008 and before November 7, 2009**, your credit was expanded 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**, and **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.**

Generally, for **purchases after November 6, 2009**, *WHBA 2009* has further expanded and extended the credit as follows: **1) Extended Deadline** - The previous sunset date of November 30, 2009 has been extended to qualifying binding home purchase contracts *entered into by April 30, 2010*, provided the contract is *closed no later than June 30, 2010*; **2) Increased Income Phase-Outs Thresholds** - The credit is phased out as your modified adjusted gross income (MAGI) increases from **\$225,000 to \$245,000** (previously \$150,000 to \$170,000) **on a joint return; \$125,000 to \$145,000** (previously \$75,000 to \$95,000) **if you are single or married and filing a separate return**; **3) Qualifying Long-Term Homeowners Now Qualify** - In addition to qualifying *first-time* home buyers, home owners who have owned and used the same principal residence for any five consecutive year period during the eight-year period immediately preceding the purchase will also qualify for the credit (up to \$6,500); and **4) Relief For Certain Military And Government Personnel** - As discussed in more detail below, military and certain government personnel who are on qualified extended assignments will get extended deadlines to purchase a home and relief from the recapture rules. **Planning Alert!** *WHBA 2009* also placed a few *new restrictions* on the home buyer's credit. Generally, for purchases after **November 6, 2009**: **1) Cap On Purchase Price** - Home purchases exceeding \$800,000 will not qualify; **2) Age Limit** - Purchasers must be at least 18 years old (or married to someone who is at least 18); and **3) Dependents Disqualified** - Anyone who is **eligible** to be claimed as another taxpayer's dependent will not qualify. **Tax Tip.** Regardless of when you bought your home, 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.

2009 Estimated Tax Relief

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.

New Sales Tax Deduction On Vehicle Purchases

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).

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 2009 and 2010**, The *2009 Act* changes the name of the HOPE credit to the **"American Opportunity Tax Credit"** and

makes five significant changes: **1) Amount of Credit** – the maximum credit is increased from \$1,800 to \$2,500 (100% of the 1st \$2,000 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*).

“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)**. 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.

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. For example, the *2009 Act* now allows you a 30% credit for “qualified energy-efficient home improvements” to your *principal residence located in the U.S. and placed in service in 2009 and 2010*, with a \$1,500 maximum cumulative credit for the 2009 and 2010 tax years (previously, there was a lifetime credit limit of \$500). Qualified improvements can include *properly certified* energy efficient roofs, insulation, exterior windows (including skylights), exterior doors, heat pumps, hot water boilers and air conditioners. In addition, the *2009 Act* allows a 30% credit for “qualified *residential* solar water heaters, geothermal heat pumps, wind energy property, and solar electric generating property” installed in your residence. **The residence need not be your “principal residence,”** so installations in your second residence or vacation home may qualify. Also, the credit will now offset the alternative minimum tax as well as regular tax. **Planning Alert!** Expenditures related to swimming pools or hot tubs (e.g., solar equipment to heat water or run electrical pumps) generally do not qualify.

2009 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,” must treat the decedent’s estate as the designated beneficiary (instead of treating the beneficiaries of the estate as the IRA beneficiaries). By making this common mistake, the beneficiaries lost a significant tax deferral opportunity. **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.

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); and **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). **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 Madoff's 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 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.

Recent Tax Legislation

NEW TAX BREAKS AVAILABLE TO BUSINESS TAXPAYERS - SELECTED PROVISIONS

5-Year NOL Carry Back Election Provides Tax Relief to Struggling Businesses

Generally, taxpayers that have a net operating loss (NOL) may carry the NOL back and offset taxable income reported in the 2 previous tax years (NOL carry back period). Any remaining unused NOL may then be carried forward to each of the following 20 years until the NOL is used up. Earlier in 2009, Congress changed the rules by allowing an "**eligible small business**" (generally, a business with average gross receipts of no more than \$15 million) to "elect" an extended NOL carry back period of up to 5 years for certain 2008 NOLs. *WHBA 2009* has now expanded and extended this 5-year NOL carry back *election*, as follows: **1) Extended To 2009 NOLs** - The election to carry back an NOL up to 5 years is available for an NOL generated in a tax year **ending in 2008 or 2009**, or a tax year **beginning in 2008 or 2009**, for fiscal year taxpayers, **and for calendar year 2008 or 2009**, for calendar year taxpayers. **2) No Gross Receipts Limit** - A business of any size (regardless of its gross receipts) may make this election; **3) 50% Limit For Fifth Year** - A qualifying 2008 or 2009 NOL may not offset more than 50% of the taxable income of the 5th carryback year (it may reduce 100% of the taxable income for the other carryback years); and **4) Election Generally Available For Only One Year** - The election is generally available for **either** a 2008 NOL or a 2009 NOL, but not both. **Tax Tip.** If an "eligible small business" previously made a timely 5-year carry back election for a 2008 NOL, it may also make the election for its 2009 NOL. **Planning Alert!** This temporary 5-year NOL carryback election is generally not available to businesses that issued an equity interest to the Federal government as part of the recent government bailout programs.

If your business has a net operating loss for either 2008 or 2009, and you are thinking about taking advantage of this election, there are many things to consider, including:

Using This Election To Recoup Prior Year Taxes. If your business is currently generating a tax loss (NOL) but was profitable in prior years, this election to carry back your 2008 or 2009 NOL for up to 5 years may provide cash from the refund of taxes you paid in previous profitable years. For example, prior to this change, your business would have been able to carry back a 2009 NOL to only the two most recent years and recoup taxes it paid in 2007 and 2008. Now, under this new provision, you may elect to carry back that same 2009 NOL and offset 50% of your taxable income reported up to 5 years back (i.e., the 2004 tax year) and get a refund of those 2004 taxes. In addition, any remaining portion of your 2009 NOL that exceeded 50% of your 2004 taxable income can then be carried forward and reduce up to 100% of your taxable income for 2005, and subsequent years. **Tax Tip.** Certain "qualified farming losses" and "qualified disaster losses" may also be carried back 5 years, and offset up to 100% (not just 50%) of the taxable income of the 5th carry back year.

Years For Which The 5-Year NOL Carry Back Election Is Available. You may make this election for an NOL for a taxable year **ending in 2008 or 2009**, or for a taxable year **beginning in 2008 or 2009**. **Planning Alert!** Except for certain “eligible small businesses,” discussed below, you generally may make this election for only one tax year, you may not make it for multiple tax years.

“Eligible Small Businesses” May Get The 5-Year NOL Carry Back For 2008 And 2009. An “Eligible Small Business” (generally, a business that satisfied a \$15 million average gross receipts test) that timely made an extended carryback election for its 2008 NOL, may also make this election for its 2009 NOL.

Increased \$250,000 Section 179 Deduction Extended Through 2009

Last year, Congress 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**. 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**.

The 50% Bonus Depreciation Also Extended Through 2009

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**. Generally, *qualifying property* includes 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!** 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**. **Passenger Automobiles.** The maximum first-year depreciation deduction (including the maximum §179 deduction) for most *business automobiles* is generally capped at \$2,960 **for 2009** (\$3,060 for trucks and vans not weighing over 6,000 lbs). However, the *2009 Act* increased the first-year depreciation cap by \$8,000 for autos qualifying for the 50% bonus depreciation in 2009. **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). 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.

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). **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.

2009 Developments Other Than New Legislation

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.

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. However, a recent Tax Court case reminds us that this leasing arrangement 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.

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.

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. **Robinson, Farmer, Cox Associates** closely monitors these changes and we will gladly discuss any current tax developments and planning ideas with you. **Please call us before implementing any planning ideas discussed in this letter, or if you need additional information.** Please note that 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.

Circular 230 Disclaimer: Any tax advice contained in the body of this material was not intended or written to be used, and cannot be used, by the recipient for the purpose of **1)** avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax law provisions, or **2)** promoting, marketing, or recommending to another party any transaction or matter addressed herein.

