

TAX NEWS & TIPS

FALL 2009

Top Priority – Health Care Reform

As I write this, Congress is under pressure to finalize a Health Care Reform bill. Their summer recess ends in late August. Whatever the outcome, the cost will be HUGE. We all will feel an impact – in our coverage, its cost, or in our taxes. If costs are passed on to big businesses, we'll still pay in the form of higher prices for goods.

Meanwhile, several important tax issues have been sidelined. We still face a sluggish economy, record unemployment, low home prices, foreign pressures, and more. Expect a flurry of tax changes late in the year. Several laws are set to end this year or next – a number are likely to be extended. Estate tax rules must change, else they expire in December (and that won't happen!).

I can't offer lots of help yet on what to expect for 2010. But, I CAN remind you of several recent changes that affect your 2009 tax bill. You still have a few months for choices that can put some dollars back in your pocket.

So Many New Laws!

We face a host of new tax laws for 2009 and 2010. It's been more than 20 years since we had so many new rules all at once. Worse, most are only temporary, which adds to the confusion. All of us need to be more alert to keep records, or we'll miss out on saving some money.

Here's a quick listing of new rules. Not a lot of explanation here. You'll need to call me if you need more details. And guess what? In some cases I'll be forced to tell you IRS has not yet written clear rules on the items! Congress writes the laws,

but IRS is hard-pressed to keep up with the details!

IRS usually devotes a page or two each year to law changes in the tax form instruction packet. This year in June they released Publication 553. It has changes for 2008 and 2009. It's a whopping 38 pages!

Sales Tax On Cars. Buy a new car after February 16, 2009? If so, the sales tax is deductible – even if you can't itemize your deductions. Only for 2009. And, only for cars under \$49,500. Even two cars, if the total cost is under \$49,500. It's lost as income ranges from \$125K to \$135K (\$250K - \$260K for couples). It's not affected by the Alternative Minimum Tax. IRS says states with no sales tax sometimes charge other fees based on a car's value – they would be deductible in the same way. No official guidance yet.

Collect Unemployment? The first \$2,400 you collect won't be taxed. This is for 2009 only.

Separated Parents. The deduction for dependents usually goes to the custodial parent. This parent can "waive" the deduction to the other parent year by year. Now IRS insists non-custodial parent must attach the signed waiver form to their tax return, even if the divorce decree allows the deduction.

Making Work Pay Credit. Anyone earning over \$6,450 at work gets \$400 knocked off the tax bill. It's up to \$800 for a couple. New tables for tax withholding in April give you the \$400 in your pay. For most folks this means nothing much. But, you get too much if you have multiple jobs, both spouses work, or other income pushes you over the limit for the credit. It phases out as income passes \$75K (\$150K for couples). What's the problem? Your return might show less credit than what you already collected –

you'll pay the excess back at tax time. You may need to change your withholding at work.

Disaster Victims. Several tax benefits may apply if you suffered loss in a Federally-declared disaster. You can find a listing of qualified disasters at www.fema.gov.

Alternative Minimum Tax. This "tax on the wealthy" is a mess. The measure of "wealthy" is from 1983, and was never revised. We've seen a series of one-year inflation adjustments for several years now. There is such a "fix" in place for 2009, but no word yet on 2010. Unless Congress rewrites this monster, an extra 24 million folks will face the tax in 2010.

From IRA to Charity. If you are over 70½, you can have your IRA custodian make charitable gifts directly from the IRA. Your income drops without needing to itemize deductions. This is a tax-wise move, but it expires at year-end.

Real Estate Taxes. 2009 is the last year you may deduct the first \$500 of real estate you pay, even if you cannot itemize deductions.

(continued on Page 2)

This Issue

- **Top Priority Health Care Reform**
- **So Many New Laws!**
- **Withholding Trap For Pensioners**
- **Small Groups – Big Savings!**
- **Yes! IRS Pays Interest!**
- **Tips For You**
- **Your Tax Calendar**

☑ **Capital Gains.** For 2009 and 2010 we still have low rates on long-term gains. Few experts expect to see these low rates in the future.

☑ **College Education.** You may choose to deduct up to \$4,000 of tuition and fees. (The deduction is set to expire this year.) Or, take one of two tax credits, if more valuable.

Lifetime Learning Credit gives a tax break of 15% of what you spent. The HOPE Credit has been revised. For 2009 and 2010 it applies to the first 4 years of college (it covered only 2 years in the past). Also new – add the cost of books and supplies, not just tuition and fees. It is a cash rebate of the first \$1,000 spent, plus 25% of the next \$1,000. Even better, up to 40% of the credit is refunded even if you have no tax. There is still a phaseout for higher income folks.

Another change is for Section 529 college savings plans. Money taken from these plans is tax-free if spent for college education – tuition, fees, books, room & board. For 2009 and 2010 you can also use the money for computers and software.

☑ **Vehicle Credits.** The hybrid car credits are rapidly running out. No more credits for Toyota or Honda

vehicles. Reduced credits in 2009 for Ford hybrids depend on purchase date. To see a list of models, go to www.irs.gov and search “alternative motor vehicle credit”. For 2009 the credits apply even if you pay the Alternative Minimum Tax. There are also generous credits for a very few of the new electric plug-in vehicles.

☑ **Business Breaks.** The liberal depreciation rules were extended to 2009. A small business may elect to write off up to \$250,000 of new equipment instead of depreciating. Elect depreciation on a 2009 item, and you can write off 50% up front, taking the balance over time. The normal first-year “cap” on a new car is \$8,000 higher for 2009. All these choices need careful study because of the future impact. It’s a sort of “Pay me now, or pay me later”.

☑ **Home Foreclosures.** If you lost your home in a foreclosure you *might* be able to ignore the cancelled debt. Relief applies only for loans that were used to buy or build the home. If you have refinanced in the meantime, you may be hit with a large tax on the forgiven debt.

There are other ways you might gain relief from cancelled debts, but they are too complex to discuss here.

This might even apply to a rental property. Call me if you need help

☑ **Inflation Adjustments.** There are dozens of other tax items that are adjusted for inflation each year:

- Standard Deductions and dependent allowances
- Income limits for making your IRA contribution deductible
- Amounts you can contribute to your pension at work
- Business driving gets 55¢ per mile this year
- Income phaseout ranges for all sorts of credits and deductions

Keep Good Records. 2009 and 2010 will be challenges for you and for me. Keeping track of all the law changes is one thing. Being able to find your information is another. Please set aside a place to keep any information that affects your taxes. It will be tough to dig this out at tax time unless you make the effort now. Yes, it’s a chore, but remember that you’ll be paid for the effort!

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Withholding Trap For Pensioners

Recent Change in Withholding Tables Helps Workers, but Pension Recipients Are in Store For a Shock!

The new Making Work Pay Credit for 2009 and 2010 gives a tax break of \$400 to most workers. To speed things up, IRS was told to revise withholding tables giving the benefit before tax returns are filed.

The Trap. Pension recipients don’t get the credit, but their withholding is calculated from the same tables! Your withholding declined in April, but your tax bill is likely to be similar to last year’s.

The change in your withholding depends on how you filled out Form W-4P. Mark “single” and withholding drops \$400. Mark “married” and it drops \$600 (the table for workers can’t know whether the other spouse works). Same tax bill, but withholding dropped. Not good!

Government retirees are affected to a lesser extent. They don’t get \$400, but qualify for a \$250 credit when they file, and thus have a smaller withholding shock.

IRS Cure? IRS realized the problem within weeks. They sent notices to pension custodians with methods to correct the change. Problem – not all custodians did the same thing. Some increased withholding within a month. Some sent a confusing letter with a new Form W-4P. Some did nothing at all!

What To Do. First, we must know what your custodian did. Check the withholding on a recent check. Compare it with withholding in January, February, or March. You may see little or no difference. If so, no problem. More likely is that withholding is now lower than you have come to expect. You need to make a decision.

Comfortable? If the change won’t cause a problem next April 15, don’t do anything.

Not comfortable? It’s time to contact the custodian. They’ll send you a new Form W-4P. If you want to use the typical “married plus allowances” or “single plus allowances” method, you’ll need help. Call me, or call the custodian.

Suggestion. This problem applies in 2010, too. But, in 2011 we return to “normal”. Will you remember to change the withholding in 2011? There’s an alternative. Form W-4P has a line allowing a fixed amount withheld. You could choose anything at all – \$75 a month, \$207 a month, anything. Check last year’s withholding. Round it up a few dollars, divide by 12 months, and use this number. When tables return to “normal” in 2011 there’s nothing to do. Please let me know of any change – I can help you “track” this to avoid surprises in later years.

Small Groups – Big Savings!

Four Hot Programs Offer Huge Benefits if You Qualify

For a very short time there's a big tax reward on the table for a small number of Americans. If you qualify for one of these, time is short to cash in on these opportunities.



“First-Time” Homebuyer.

For some folks IRS offers up to \$8,000 in cash for buying a home. You qualify if you haven't owned a home in the 3-year period before the closing on your purchase. The actual credit is 10% of the home's cost, but caps out at \$8,000. Buy the home before November 1, 2009 to qualify, as long as your income is below \$75,000 (\$150,000 for couples). You'll need to live there for 3 years to cement the deal, else you pay the money back. Buy with a partner, and divide the credit as you see fit. When both qualify, split the credit any way you like. If one buyer can't qualify, the other can take it all. If a couple wants to buy a marital home, there can be a trap – both spouses must qualify, or no credit. Avoid this by buying *before* you say “I Do”.



Cash For Clunkers.

A brand-new law, passed on June 18, aims to get those older gas guzzlers off the highway. It offers \$3,500 or \$4,500 to dump an older car in favor of a more fuel-efficient vehicle. The offer only runs from July 1 through the end of October. You must buy a new car for \$45,000 or less. Used cars don't qualify. If your new car's “combined fuel economy” (CFE) beats the old car's by 4 mpg, you get \$3,500. If the new CFE is 10 mpg better, it's \$4,500. Rules are a little different for SUVs and trucks, which are broken into three classes, but the idea is similar.

WARNING: This is not an *extra* trade-in allowance – it *replaces* the allowance. Dealer will look up your qualifying voucher amount, and give the reduction in the final sale price – dealer later receives cash for the voucher. Clearly you don't want this deal if your vehicle's trade-in value is higher than the voucher amount. The dealer cannot resell your vehicle – it must be destroyed. Remember, I said they wanted these older gas guzzlers

Yes! IRS Pays Interest!

When you owe the IRS, they charge interest – compounded. They also pay interest when they owe you money – but the rules work in their favor!

If you're the one who owes, the rate is determined by law. Suppose you still owe \$1,000 on your 2008 taxes. Two rules favor the IRS. (1) They charge interest from April 15 – the day payments were due. (2) They add a “late payment” penalty, and it can be as high as ½% per month.

When they owe you, it's a little different. (1) Forget the penalty, all you can ever see is interest. (2) Interest begins 45 days after your claim. The 45 days is a sort of “grace period” allowed for IRS to process and evaluate your claim.

Example 1. You *file* your 2007 return 1½ years late, in October 2009. If you owe, you pay interest (plus penalty) from April 15, 2008 until you pay. On the other hand, if there's a refund, IRS won't pay interest unless they delay payment more than 45 days – you're late in making your claim.

Example 2. We *amend* a timely-filed 2007 return in October 2009, claiming a refund. The return's due date was April 15, 2008. If IRS pays you within the allowed 45 days, they will pay interest from April 15, 2008 until the date you filed the amendment in October 2009.

Interest rates, whether for underpayment or overpayment, are reviewed and set every quarter. Back in 2006 and 2007 the rates were as high as 8%. 2008 began with a rate of 7%, and settled at 6% in the last three quarters. The first quarter of this year it was 5%, but now is 4%.

off the road! Other catches: Your old vehicle must be not over 25 years old, must be drivable, and you must have owned, registered, and insured it for one full year. Get CFE ratings and other details from car dealers or go to www.fueleconomy.gov, or to www.cars.gov.



Energy Credits. Everyone's talking about “going green”.

The government offers generous tax incentives to save energy. Credits are biggest for costly ventures, like solar power generating and geothermal. Homeowners can cash in on smaller credits with fairly common home improvements. For 2009 and 2010 you can get a tax rebate of up to 30% of the first \$5,000 you spend on the right sort of improvements.

Improvements that qualify: most insulation, doors and windows, some roofing materials, furnaces, heaters, water heaters, main circulating fans, air conditioners, and biomass fuel stoves. This must be your principal residence, and specific energy-saving standards must be met. Standards are complex, but IRS announced we may rely on manufacturer's statements. Look for printed material talking directly about the tax credits, or go to the manufacturer's website. We won't need to send these documents with your return, but you will need to keep copies of these certifications along with your other tax records.



Required Distributions.

Folks over 70½ must begin taking money from their IRA and pension accounts. For 2009 the rule was waived – take as little or as much as you wish for 2009. This offers a chance to some elderly folks to save significant tax dollars. Clearly, if you need the money for expenses, this is no help. But, if you don't need the full amount, what should you do?

Suppose your normal required distribution is \$10,000. You don't really need it. If you leave it, you save tax on the \$10,000. But, what if part of the \$10,000 would be taxed at 15%, and the rest at 25%. Why not take only the part in the 15% tax bracket? I can help you figure this out. To do this correctly, we must estimate your other income for 2009.

Several items can come into play, not just tax bracket. Your income affects the amount of your social security benefit subject to tax, the level at which medical expenses are deductible, and several other items on your tax return. If you pass away, the money is taxable to your heirs. We may need to consider whether their tax brackets are significantly higher or lower than yours.

I can help look for a benefit, but only if I know the amounts of other income. We have until December 31 to decide on any distribution. Once 2010 begins, it will be too late.

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Tips For You

Ponzi Scheme Victim? If you lost money in an investment scheme, you may find some relief in a new stance taken by IRS. In the past, we could not claim your loss until the precise extent of the loss was known – and this can take years of court battles. Three changes are very helpful to taxpayers. (1) IRS says you claim the loss in the year a Court hands down a criminal indictment against the principals. (2) New safe harbor rules say you claim 95% of what is outstanding, or 75% if you are part of a separate legal action to recover the loss. (3) IRS says the loss is a business loss – a big benefit, as this removes “floors” required for theft losses, and raises options that may open prior tax years for relief.

Cell Phone Rules To Be Eased. Current law is tough on cell phones, especially if provided by employer. IRS wants income added to a W-2 if any personal use is allowed. In 1984 Congress invented “Listed Property” – items where the line may be cloudy between business and personal use. It includes cars, boats, and airplanes. Also affected are devices “used for leisure, recreation, or entertainment” – vacation properties, cell phones, computers, and devices for home entertainment. What teacher didn’t hope to write off the video recorder after taping some show for use in the classroom? For such property, the

law demands detailed records of all usage, and denies deductions unless business use has always been above 50%. Does your log show the nature of each call on your cell phone? IRS now agrees this is not realistic.

IRS knows today’s cell phone is very different from 1984’s mobile phone. They want a set of rules to allow some personal use without demanding records of every single call. They hope to issue new rules late in the year. At the same time, they asked Congress to review the issue. We might see more new law.

Back To School Issues. Going to school was not a tax issue until the last 10 years or so. Now we have a host of tax breaks, as mentioned two pages earlier. These might help you – but, only if you keep records!

Below college level only a single break applies. Is there a Coverdell Education Savings Account for any of your children? If so, the money’s been growing tax-free. You can take money from the account without paying tax on the growth – if you spend the money on education expenses from grade school on up.

College and on. Here we have tax deductions, tax credits, and the special savings programs. To claim them properly we need records of different *categories* of expense. Tuition and fees, books and supplies, computers and software, room and board, and transportation, each belong to a separate category. The full set of rules is too complex to

describe here, but if you have the expenses properly divided, I can make sure you get the largest possible tax savings.

Extensions Expire October 15.

A few of you still have not filed for 2008. Please make an effort to find the missing information. We have little time left. In most years I am not quite as busy this time of year. 2009 is very different! I expect to have more tax-planning work with clients who are confused over new rules. At the same time, I want to give my full attention to your returns, and keep your taxes to the absolute minimum.

The only difference between a tax man and a taxidermist is that the taxidermist leaves the skin.

Mark Twain

Your Tax Calendar

Sept. 15	3 rd quarter estimated tax payments due.
Oct. 15	Extensions to file 2008 Form 1040 expire.
Oct. 31	3 rd qtr. payroll returns due. (Nov. 10 if tax paid in full and on time.)
Dec. 31	Last chance for deductions in 2009.
Jan. 15	4 th quarter estimated tax payments due for 2009.