



Client advisor

CURRENT INFORMATION, NEWS AND TRENDS

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Inside This Issue:

- Six Valuable Tips for the Unemployed
- Taking Your Business Home
- Hope Is Gone; American Opportunity Is In
- Relief Is Here! RMDs Have Been Waived for 2009.
- 2009 Brings "Add-Ons" to the Standard Deduction
- Time Is Running Out for the \$8,000 First-Time Homebuyer Credit
- Tax Calendar
- Since You Asked...

Six Valuable Tips for the Unemployed

If you have, unfortunately, joined the many individuals who are unemployed due to the current economic downturn, there are a number of tax provisions available in 2009 that you may find helpful in weathering a difficult period.

Unemployment Compensation – Partially Tax-Free –

Although some states don't tax unemployment compensation, it is taxable income for federal purposes. However, for 2009, there is no federal income tax on the first \$2,400 of unemployment benefits; the balance is taxable. For a married couple, the exclusion applies to each spouse individually. Thus, if both spouses receive unemployment benefits during 2009, each may exclude from income the first \$2,400 of benefits he or she receives.

COBRA Continuation Premium Subsidy – If you were eligible for COBRA medical insurance continuation with your prior employer between September 1, 2008 and December 31, 2009, you are probably qualified for the tax-free premium subsidy equal to 65% of the cost of the insurance for a period of up to nine months. The former employer pays the subsidy but is reimbursed by the government. This benefit is not available if your adjusted gross income for the year is over \$145,000 (\$290,000 married joint filers). If you think you might qualify, contact your former employer.

Costs of Seeking New Employment – The costs incurred while seeking new employment are generally deductible as a miscellaneous itemized deduction. These include the cost of preparing, reproducing and mailing resumes; employment agency fees; travel expenses including auto travel at 55¢ per mile, airfare, out-of-town lodging and 50% of meals; long-distance telephone charges; etc. The expenses must be for searching for a new job in the same field as was your previous employment.

Certain Penalty-Free Pension Withdrawals Permitted –

Although all pension withdrawals are generally taxable, the early withdrawal penalties can be avoided when the withdrawals are to pay:

• **Unreimbursed Medical Expenses** – Amounts withdrawn from any qualified plan to pay unreimbursed medical expenses that would be deductible on Schedule A during the year and

that exceed 7.5% of the taxpayer's AGI are exempt from penalty. This is true even if you don't itemize your deductions.

• **Medical Insurance** – This exception allows you, if qualified, to make penalty-free withdrawals from your IRA to pay for medical insurance for yourself, your spouse and dependents. To qualify for this exception, you or your spouse must have lost your job; received unemployment compensation for 12 consecutive weeks; made withdrawals during the year the unemployment was received or in the following year; and made the withdrawals no later than 60 days after being re-employed.

• **Higher Education Expenses** – Withdrawals made from an IRA during the year for qualified higher education expenses for yourself, spouse, children or grandchildren are exempt from the early withdrawal penalty.

• **Home Sale Exclusion** – Generally, to qualify for the exclusion of gain, a taxpayer must own and use the home as his or her primary residence for two of the prior five years. However, where you are forced to sell the home because of a job-related move, you can no longer afford to maintain it, or you are eligible for unemployment benefits, you can qualify for a partial prorated exclusion without meeting the two-year qualification period.

Gifts – If you are receiving assistance from a family member in the form of a gift, you should be aware that the gift is not taxable income to you, nor is it deductible by your benefactor. However, the person making the gift may need to file a gift tax return if he or she gives you more than \$13,000 during 2009. The giver can gain some tax benefit by gifting appreciated property, thereby transferring the tax liability for the gain to you at – hopefully – a lower tax rate. For example, a parent makes a gift to his child of appreciated stock. If the parent sells the stock and gives the child the cash, the parent must also pay the income tax on the gain. On the other hand, if the parent gives the stock to the child, who then sells it, the child will be taxed on the gain. Call this office if you are considering such a strategy.

If you would like to discuss any of the tax provisions mentioned here, please contact this office for an appointment.



Taking Your Business Home

The economic downturn has many businesses struggling to stay afloat. With so much at stake, some owners have moved their businesses into their homes to save money. If you are considering this option, then you need to be aware of the rules that apply when deducting home office expenses.

Generally, a self-employed individual will qualify for a home office deduction if the office is a place where the taxpayer meets with customers, patients or clients, or is used on an exclusive and regular basis for administrative or management activities of his or her trade or business, and there is no other fixed location of the business where the taxpayer conducts substantial administrative or management activities of the business. Even if a taxpayer conducts administrative activities at a fixed location outside the home, he or she is still eligible to claim a deduction as long as the administrative activities conducted at the outside location aren't substantial. Space in the home used to store inventory for a wholesale or retail business also qualifies as business use of the home.

Deductible home office expenses fall under two basic categories: direct and indirect expenses. Expenses that are directly attributable to the home office, such as painting the office, repairs to the office space, etc., are 100% deductible to the business. The second category is indirect expenses that are attributable to the entire home, for which only a fraction of the total amount is allocated to the home. These include home mortgage interest, property taxes, insurance, certain utilities and depreciation. If the home is rented, substitute rent paid for interest, taxes and depreciation. The fraction used to allocate business portions of the indirect expenses is determined by dividing the business use square footage by the total square footage of the home.

The home office deduction is, however, limited to the gross income of the business derived from the use of the home for that business, and where the gross income is less than the expenses, certain expenses can be carried forward for the same trade

or business in the subsequent years but cannot be used against a positive income from another business. Carryover never includes home interest, taxes and casualty losses because they are allowed without regard to the gross income limitation.

If the self-employed taxpayer owns the home, there is a negative aspect to the home office deduction that can create unexpected consequences when the home is sold. First, the allowable home office depreciation is never excludable under the \$250,000 (\$500,000 for joint filers) exclusion of gain for primary residences and will end up

being recaptured as taxable income upon sale. Worse yet, if the office is located in a separate structure, then the home sale is treated as two sales (the sale of the home portion and the sale of the office portion). Any gain from the office portion would not qualify for the home gain exclusion and would be taxable.

For example, a married couple sells a home that includes a home office in a separate structure that is 20% of the total home square footage. The home, originally costing \$150,000, is sold for \$500,000. If the home office had never been claimed, or if the office had not been in a separate structure, the entire home gain, except recaptured depreciation, could be excluded from income. However, in this case, \$70,000 (20% of the gain) becomes taxable income. (For this example, to keep it simple, we haven't taken into account improvements, selling costs, or depreciation.)

If you would like to learn more about how the business use of your home might affect your taxes, please give this office a call.



Hope Is Gone; American Opportunity Is In

For a number of years, the tax code has provided an education incentive in the form of tax credits for post-secondary education tuition paid during the year for taxpayers and their dependents. Until 2009, these credits consisted of the Hope Credit, which was generally limited to a tuition credit that was capped at \$1,800 (2008 cap) for each of the first two years of post-secondary education for each student, and the Lifetime Learning Credit, which provides up to \$2,000 of credit for each family every year. In 2008, these credits were phased out for joint filers with incomes between \$96,000 and \$116,000 (\$48,000 to \$58,000 for single filers) and not allowed at all for married individuals filing separately.

Hope Is Gone in 2009 and 2010 – The Hope Credit is out for 2009 and 2010 and has been replaced by the American Opportunity Tax Credit, which increases the maximum credit allowed by almost 40%, doubles the number of years for which the credit is available, expands the types of expenses eligible for the credit, and substantially raises the income thresholds for phasing out the credit. Whereas the Hope Credit was nonrefundable and only offsets your income tax, the American Opportunity Tax Credit is partially refundable, thus providing more benefits to lower-income taxpayers.

American Opportunity Tax Credit Is In – The American Opportunity Tax Credit replaces the Hope Credit for 2009 and 2010. It provides credit for four years of college expenses, and the maximum credit per student increases to \$2,500 per year. The credit will be based on 100% of the first \$2,000 – and 25% of the next \$2,000 – of tuition, fees and course material (including books) expenses paid during the tax year. 40% of the credit is refundable, provided the taxpayer is not: (1) a child under the age of 18 or (2) under the age of 24, a full-time student and is not self-supporting. For higher-income taxpayers, this credit begins to phase out for AGI in excess of \$80,000 (\$160,000 for married couples filing jointly), a significant increase from the previous phase-out thresholds noted above. This enhanced credit can be used to offset the alternative minimum tax in both 2009 and 2010.

Please call this office if you would like additional information on the new education incentive.

Relief Is Here! RMDs Have Been Waived for 2009.

Retirement plan account participants, IRA owners, and their beneficiaries do not have to take their required minimum distributions (RMDs) attributable to 2009. Congress waived those RMDs for 2009 so that distributions would not have to be taken while the stock markets – and, correspondingly, plan values – were at a low, in hopes that the markets would recover quickly.

Beneficiaries taking retirement plan distributions over a five-year period can also waive the distribution for 2009, effectively permitting the beneficiary to take distributions over a six-year period.

However, this special one-year relief from taking RMDs **does not** apply to 2008 RMDs that were deferred until 2009, since those are actually delayed 2008 distributions; therefore, they are not included in the waiver relief for 2009 distributions.

Does this mean that you cannot or should not take a distribution in 2009? Not necessarily; you can still take a distribution if you need or want to. Even if you do not need to take a distribution, it may be appropriate for you to take one based on your income and deductions for the year. If your taxable income is negative, you can take a distribution equal to the negative amount free of any taxes. If you are in an abnormally low-income year, you may also wish to take a distribution and take advantage of a lower-than-normal tax rate.

If you don't know how to proceed and need some guidance, please call this office for an appointment.

2009 Brings "Add-Ons" to the Standard Deduction

You would think a standard deduction would be a fixed amount. Well, for 2009, that's not the case! In addition to the long-standing additions for being age 65 and over and being blind, you can also add on certain items for 2009 that normally would be deductible only to those who itemize their deductions. Don't think that this article is only applicable to taxpayers using the standard deduction; some who would normally itemize may find it to their advantage to use the standard deduction plus the special add-ons in 2009.

So how is the standard deduction for 2009 determined? We start off with the basic standard amount, which is \$11,400 for joint filers, \$8,350 for those filing head-of-household and \$5,700 for all others. To that, you would add the age and blind extra amounts, which are \$1,100 each for joint filers and \$1,400 for others. For example, a married couple both age 65 or over and one blind would qualify for an extra amount of \$3,300 (\$1,100 x 3). The following items that would normally require itemizing would be added to that total:

- **Real Property Tax** – Limited to \$1,000 for joint filers and \$500 to others.
- **New Vehicle Sales Tax** – Limited to the tax on the first \$49,500 of each new vehicle purchased from February 17, 2009 through December 31, 2009 and subject to phase out for higher-income taxpayers.
- **Disaster Casualty Losses** – Defined as a casualty loss related to a federally declared disaster.

Continuing our previous example, if the couple had \$2,400 of new car sales tax and real property taxes of \$1,500, their total standard deduction for the year would be computed as follows:

Basic Standard Amount for Joint Filers	\$11,400
Both Age 65+ (2 x \$1,100)	\$2,200
One Blind (1 x \$1,100)	\$1,100
Auto Sales Tax	\$2,400
Property Tax (Limited to a maximum of \$1,000)	\$1,000
TOTAL	\$18,100

An added complexity is the alternative minimum tax, which does not allow the standard deduction with the exception of the qualified motor vehicle sales tax and disaster casualty loss deductions.

To determine whether to itemize or take the enhanced standard deduction requires computing both and using the better result. This office will do that automatically if you provide the necessary information.

Time Is Running Out for the \$8,000 First-Time Homebuyer Credit

You need to act soon if you want to take advantage of the \$8,000 first-time homebuyer credit. This once-in-a-lifetime home purchase incentive only applies to purchases completed before December 1st of this year. Although this benefit is called a tax credit, it is actually a financial subsidy to help taxpayers purchase a home located in the U.S. It does not have to be repaid if the home is occupied as a principal residence for the first 36 months after its purchase. The credit is 10% of the cost of the home, up to a maximum credit of \$8,000; therefore, nearly all qualified first-time homebuyers will be eligible for the \$8,000 maximum, considering that homes selling for less than \$80,000 are very rare in most parts of the country. If the credit exceeds your tax, you can claim a refund of the excess.

A taxpayer is considered a first-time homebuyer if he or she (and spouse, if married) had no present ownership interest in a principal residence in the U.S. during the three-year period before the purchase of the home to which the credit applies. However, this credit is not available to high-income taxpayers and begins to phase out for married couples with adjusted gross incomes (AGI) in excess of \$150,000 and for unmarried taxpayers with AGI in excess of \$75,000.

The credit is available on a taxpayer's 2009 return or amended 2008 return, which means that the funds are not available until after the refund is received from either of those filings. This can be a problem for some potential buyers who have difficulty coming up with funds for the required down payment and closing costs. Recently, however, the Department of U.S. Housing and Urban Development announced that the Federal Housing Administration (FHA) will allow homebuyers to apply the \$8,000 first-time homebuyer tax credit toward the purchase costs of an FHA-insured home.

FHA-insured home mortgages require a minimum 3.5 percent down payment, and under the terms of this modified policy, lenders can now monetize the tax credit for use as additional down payment or for other closing costs, which can help achieve a lower interest rate. In addition to the borrower's own cash investment, the FHA allows parents, employers and other governmental entities to contribute towards the down payment.

If you have questions about how this credit will apply to your specific circumstances or to those of a child or relative looking to purchase a home, please give this office a call.



Tax calendar

Sept. – Dec. 2009

September – December:

- Time for your 2009 Fall and 2010 Tax Planning. Contact this office to schedule a consultation appointment.

September 15, 2009:

- The third installment of 2009 individual estimated taxes is due.
- This is the FINAL extended filing due date for your 2008 calendar year partnership returns (Form 1065), fiduciary returns (Form 1041), S corporation returns (Form 1120S), and corporation returns (Form 1120).

October 15, 2009:

- This is the FINAL extended filing due date for your 2008 individual income tax return.

December 31, 2009:

- This is generally the LAST day that you can pay tax-deductible expenses for the year. IRA contributions and some self-employed retirement plan contributions can be made after the close of the year.

The purpose of this newsletter is to provide current information on tax, financial and business developments. It suggests general tax planning ideas that may only be appropriate when claiming tax benefits in a manner consistent with the statutes and Congressional purpose. The information and opinions are generalizations and may not apply to all taxpayers and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. Therefore, it is important that you seek appropriate advice before implementing any of the ideas suggested.

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Since You Asked...



You Asked: My wife is confined to a wheelchair so I would like to make some modifications to our home to make it more accessible to her. Can I deduct those modification costs as a home improvement?

Answer: Generally, home improvements are not deductible except to offset home gain when the home is sold. But a medical expense deduction may be claimed when it is a medically-necessary home modification. The modification expense is deductible as a medical expense to the extent it exceeds any resulting increase in the value of the property. The full cost of certain improvements can be included as medical expenses, because they are considered not to increase the home's value. Examples of these types of improvements include constructing entrance or exit ramps for the home; widening entrance/exit doorways, hallways and interior doorways; installing railings and support bars; and lowering or modifying kitchen cabinets. Note, however, that medical expenses can be claimed only to the extent that they

exceed 7.5% of the taxpayer's adjusted gross income (AGI) (10% if taxed by the AMT).

You Asked: I noticed that my payroll withholding dropped a small amount in the spring. I didn't think much about it at the time, but that decrease is adding up and causing me some concern. Since I usually break even at tax time, I don't want to end up owing taxes next year.

Answer: Your decrease in withholding is probably attributable to the new "Making Work Pay Tax Credit." This is being paid to taxpayers in advance of filing their 2009 tax returns by way of a payroll withholding reduction. The reduction was accomplished by tweaking the withholding tables, which does not consider your specific tax circumstances. Unless your income is above \$75,000 (\$150,000 for joint filers), you will probably qualify for the tax credit of \$400 (\$800 for joint filers) to offset this reduction. Compare your estimated reduced withholding for the year with the credit; if you feel that there is problem, give this office a call.