



tax & financial

U P D A T E



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Is This the Year to Convert Your 401(k) to a Roth IRA?

One benefit of a Roth IRA over other forms of retirement savings is that, when the funds are withdrawn, they are not taxable. However, all contributions to a Roth IRA are post-tax and the real benefit lies in the tax-free earnings accumulation. The tax code includes provisions that allow you to roll over other retirement funds to Roth IRAs.

If you expect your 2009 income to be lower than normal because you've been forced to take a pay cut, your investments aren't producing the income they used to, or for other reasons due to the current recession, it may be an opportune time to convert some or all of your 401(k) funds into a Roth IRA. Although the amount rolled over will be taxable, if your tax bracket is lower than normal, it may present an opportunity that should be considered. This can be done by rolling over money from your 401(k) to a Roth IRA, provided both of the following conditions for the year of the rollover are met:

1. Your modified adjusted gross income (MAGI) for Roth IRA purposes is \$100,000 or less; and
2. You are not a married individual filing a separate return.

You can elect, with your plan administrator, to do a direct rollover where the funds are transferred directly from your 401(k) account to the Roth IRA account. The plan administrator will complete Form 1099-R so that it properly reflects the rollover to the Roth IRA.

If you choose to receive the 401(k) money and roll it over yourself, simply roll it to a Roth IRA within 60 days of receipt. In this case, the administrator is required to withhold 20% of the distribution for federal income taxes (which is claimed on your tax return just as you do income tax withheld from your wages). Therefore, you will have to replace the 20% withheld for income taxes with other funds if you want to roll over the entire amount that was withdrawn from your 401(k) account.

You must include in your gross income the total previously untaxed amount that was in your 401(k) account (up to the amount withdrawn).

A traditional IRA can also be converted to a Roth IRA if the two conditions listed above are met.

The amount of tax you will have to pay on the conversion will be based upon your tax bracket for the year. For instance, if you are in the 15% tax bracket and roll over \$20,000 of taxable distributions into a Roth IRA, your federal tax would be \$3,000 (.15 x \$20,000). You may be subject to state tax as well.

A word of caution... if you use part of the 401(k) funds to pay the rollover tax, those funds are not treated as part of the rollover and, instead, are treated as a premature distribution subject to an additional 10% early withdrawal penalty.

Example: You are in the 15% tax bracket and take a \$20,000 distribution on which \$4,000 (.20 x \$20,000) is withheld. \$1,000 of the withholding deduction is replaced with other funds and \$17,000 is rolled over into the Roth IRA. You would be subject to a 15% tax on the entire \$20,000, plus a 10% penalty on the \$3,000 that wasn't rolled over. Thus, the total federal liability created by the rollover would be \$3,300. The 10% penalty will not apply if you are over age 59½ when the 401(k) withdrawal is made.

Does your AGI exceed \$100,000? If so, you cannot make the conversion in 2009, and will have to wait until 2010 when the AGI limitation will be removed.

If you are considering a Roth conversion, it would benefit you to consult with this office in advance.

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.

Are You Being Snared by the **Alternative Minimum Tax?**

Originally conceived to combat taxpayers in the higher-income brackets who utilized legal tax shelters and tax preferences to avoid paying income tax, the alternative minimum tax (AMT) can be tricky and hit you when least expected. The tax was supposed to inflict a "minimum" tax on those who were able to avoid the regular tax. However, years of inflation have pushed many middle-income taxpayers into the reach of the AMT. Although there is a long list of items that can trigger the AMT, for most individuals, the triggers include the following or a combination of the items listed below:

- Preference income from exercising stock options from an employer's qualified plan, sometimes referred to as incentive stock options (ISOs);
- Having large miscellaneous itemized deductions;
- Large itemized deductions for state income or sales tax, real property tax and personal property tax;
- Large medical itemized tax deductions;
- Home equity debt interest deduction; and
- Interest income from private activity bonds.

Because of its unintended impact on the middle class, Congress has been promising AMT reform. However, the AMT as it is currently structured provides a significant amount of tax revenue that Congress is reluctant to concede without a replacement. So each year for the past several years, they have been applying one-year patches to AMT in the form of inflation adjustments to the amount of income exempt from AMT.

For 2009, Congress has patched the AMT for yet another year by increasing the AMT exemption amount and continuing to allow nonrefundable credits to offset this punitive tax. The following are the details of the 2009 patch:

- **AMT Exemption Amount for 2009 Increased** – The AMT exemptions have been increased for 2009 to: \$70,950 (up from \$69,950 in 2008) for married individuals filing jointly, \$46,700 (up from \$46,200 in 2008) for unmarried individuals and \$35,475 (up from \$34,975 in 2008) for married individuals filing separately. The AMT phase-out rules remain unchanged.
- **AMT Relief for Nonrefundable Personal Credits** – Nonrefundable personal credits will offset the AMT for 2009. Those credits include the dependent care credit, elderly and disabled credit, education credits, adoption credit, child tax credit, mortgage credit, saver's credit, certain residential home energy credits, first-time homebuyer credit and plug-in electric vehicle credit.

Even with the patch, a significant number of taxpayers are finding themselves snared by the AMT. You can tell if you were hit by the AMT by looking at line 45 of your 2008 Form 1040. The amount on that line (if any) represents the extra tax (AMT) you are paying over and above the regular income tax.

There are planning techniques that can be used to avoid or mitigate the effects of the AMT. If you anticipate an AMT problem this year, it may be appropriate for you to make an appointment to see if there are any steps that can be taken to alleviate the effects of the AMT in your specific tax situation.



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.

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.

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.



Since You Asked...

You Asked: I was visiting with my sister this summer and we ended up talking about each other's financial situation and taxes. It turns out that our yearly incomes are about the same, but the amount of taxes that we pay is entirely different. My income is from a pension and interest income; my sister's income is mostly dividends and gains from sales of stocks. We are both widows and collect about the same amount of Social Security benefits. Neither of us itemizes our deductions. My tax for 2008 was almost \$6,000, while hers was just over \$1,000. How can this be?

ANSWER: Your sister is benefiting from the capital gains tax rates. For 2008 and through 2010, to the extent that taxable income would otherwise be in the 10% or 15% tax brackets, there is a zero percent capital gains tax rate on long-term capital gains and qualified dividends. And if taxable income falls above the 15% bracket, most long-term capital gains and qualifying dividends are taxed at no more than 15%. Your sister's taxable income consists mostly of the type of income that is eligible for these lower

rates, with a large portion of that income apparently qualifying for the 0% tax rate. That explains why her tax is substantially less than yours. Fair? Perhaps not, but that's the law.

You Asked: My daughter is entering college this year, and my parents have indicated that they will help out by paying her tuition. Can they claim the tuition credits?

ANSWER: Tax regulations provide that solely for education credit purposes, if a third party makes a payment directly to an eligible educational institution for a student's qualified tuition and related expenses, the student would be treated as receiving the payment from the third party, and, in turn, paying the qualified tuition and related expenses. Furthermore, qualified tuition and related expenses paid by a student would be treated as paid by the taxpayer if the student is a claimed dependent of the taxpayer. Thus, in your case, the tuition will be treated as paid by you. If otherwise qualified, you will be the one to claim the credit.



taxcalendar September – December 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.