2009 Regional Forums - Individual Developments

New Laws

Impending new law clarifies the Code's uniform definition of child

New rules. For tax years beginning after 2008, the Act provides that:

... an individual who otherwise satisfies the uniform definition is not treated as a qualifying child unless he is either: (1) younger than the individual claiming him as a qualifying child or (2) permanently and totally disabled; (Code Sec. 152(c)(3)(A), as amended by Act § 501(a))

... the child tax credit is available only for a qualifying child for which the taxpayer is allowed a deduction under Code Sec. 151 ; (Code Sec. 24(a), as amended by Act § 501(c)(1))

... an individual who is married and files a joint return (unless the return is filed only to claim a refund) is not considered a qualifying child for child-related tax benefits, including the child tax credit; (Code Sec. 152(c)(1)(E), as amended by Act § 501(c)(2)) and

... if a parent may claim a particular qualifying child, no other individual may claim that child as a qualifying child under the uniform definition; under an exception if no parent claims the qualifying child, another individual may claim the child if that individual (1) is otherwise eligible to claim the child and (2) has a higher adjusted gross income for the tax year than any parent eligible to claim the child. (Code Sec. 152(c)(4), as amended by Act § 501(c)(2))

AMT Relief in the Emergency Economic Stabilization Act of 2008

Boosted AMT Exemption Amounts

New law. Under the Emergency Economic Stabilization Act (signed into law by President Bush on October 3), the AMT exemption amounts (before phaseout) for 2008 for individuals are:

... $69,950 for married individuals filing jointly and surviving spouses (up from $66,250 for 2007);

... $46,200 for unmarried individuals (up from $44,350 for 2007); and

... $34,975 for married individuals filing separately (up from $33,125 for 2007). (Code Sec. 55(d)(1) as amended by Act Sec. 102(a) of Division C)

RIA observation: The Act does not tinker with the AMT phaseout rules.

Personal Nonrefundable Credits May Offset AMT and Regular Tax

New law. Under the Act, for tax years beginning in 2008, the combined total of the following credits is limited to the sum of: (1) regular tax liability reduced by the foreign tax credit allowable under Code Sec. 27(a), and (2) the AMT: (Code Sec. 26(a)(2), as amended by Act 101(a) of Division C)

... Code Sec. 21 dependent care credit;

... Code Sec. 22 credit for the elderly and permanently and totally disabled;

... Code Sec. 23 adoption credit;

... Code Sec. 24 child tax credit;

... Code Sec. 25 mortgage credit;

... Code Sec. 25A Hope and Lifetime Learning credits;

... Code Sec. 25B lower income saver's credit;

... Code Sec. 25C nonbusiness energy property credit for energy-efficient improvements to a principal residence;

... Code Sec. 25D residential energy efficient property credit; and

... Code Sec. 1400C first-time D.C. homebuyer credit.

RIA observation: In other words, under the Act, the sum of the above credits may offset both regular tax and AMT.

AMT Refundable Credit Amount Liberalized

New law. For tax years beginning after 2007, the Act generally allows the long-term unused MTC to be claimed over a two-year period (rather than five years) and eliminates the AGI phase-out. (Code Sec. 53(e)(2), as amended by Act Sec. 103(a) of Division C)

It also provides that any underpayment of tax outstanding on Oct. 3, 2008 which is attributable to the application of the minimum tax adjustment for ISOs (including any interest or penalty relating thereto) is abated.

Individual and Business Tax Breaks Extended by the Emergency Economic Stabilization Act of 2008

Election to Deduct State & Local General Sales Tax Retroactively Extended Through 2009

New law. The Act retroactively extends the election so that it applies for tax years beginning before Jan. 1, 2010. (Code Sec. 164(b)(5), as amended by Act Sec. 201 of Division C).

RIA observation: In other words, taxpayers may elect on their 2008 and 2009 federal income tax returns to claim an itemized deduction for state and local general sales taxes instead of the itemized deduction for state and local income taxes.

Above-the-Line Deduction for Higher Education Expenses Retroactively Extended Through 2009

New law. The Act retroactively extends the above-the-line tuition deduction so that it sunsets for tax years beginning after Dec. 31, 2009. (Code Sec. 222(e), as amended by Act Sec. 202 of Division C)

RIA observation: In other words, eligible taxpayers may claim the above-the-line deduction for qualified tuition expenses on their 2008 and 2009 federal income tax returns.

Above-the-Line Deduction for Educator Expenses Retroactively Extended Through 2009

New law. The Act retroactively extends this $250 deduction so that it's available for tax years beginning before Jan. 1, 2010. (Code Sec. 62(a)(2)(D), as amended by Act. Sec. 203 of Division C) Thus, educators may claim the above-the-line deduction for eligible expenses on their 2008 and 2009 federal income tax returns.

Additional Standard Deduction for State and Local Property Taxes Extended for One Year

New law. The Act extends the additional standard deduction for state and local property tax for one year. In other words, it applies for tax years beginning in 2008 or 2009. (Code Sec. 63(c)(1)(C), as amended by Act Sec. 204 of Division C)

Two-Year Extension for Nontaxable IRA Transfers to Eligible Charities

New law. The Act retroactively extends this deduction so that it's available for tax years beginning after Dec. 31, 2007, and before Jan. 1, 2010. (Code Sec. 408(d)(8)(F), as amended by Act Sec. 205 of Division C)

Research Credit Extended and Modified

New law. The Act retroactively extends the research credit so that it applies for amounts paid or incurred through Dec. 31, 2009. (Code Sec. 41(h)(1)(B), as amended by Act Sec. 301(a)(1) of Division C)

One-Year Extension for New Markets Tax Credit

New law. The Act extends the new markets tax credit through 2009. (Code Sec. 45D(f)(1)(D), as amended by Act Sec. 302 of Division C)

15-Year Writeoff for Qualified Leasehold Improvements and Qualified Restaurant Property Extended for Two Years and Liberalized

New law. The Act extends the 15-year writeoff for both qualified leasehold improvement property and qualified restaurant property for two years, that is, it applies for eligible property placed in service through Dec. 31, 2009. (Code Sec. 168(e)(3)(E), as amended by Act Sec. 305(a))

Two-Year Extension for Rule Providing That S Corporation Contributions Result in Lower Shareholder Basis Adjustments

The Pension Protection Act of 2006 amended this rule to provide that the amount of a shareholder's basis reduction in S stock by reason of a charitable contribution made by the corporation is equal to his pro rata share of the adjusted basis of the contributed property.

New law. The Act retroactively extends the PPA rule so that it applies for contributions made in tax years beginning before Jan. 1, 2010. (Code Sec. 1367(a)(2), as amended by Act Sec. 307 of Division C)

New Tax Provisions in the Emergency Economic Stabilization Act of 2008

Refundable Child Credit Eased

New law. For the 2008 tax year, the Act modifies the earned income formula for the determination of the refundable child credit to apply to 15% of earned income in excess of $8,500. (Code Sec. 24(d)(4), as amende by Act Sec. 501 of Division C)

Certain Farming Business Machinery and Equipment Treated as 5-year Property

For property placed in service after 2008 and before 2010, the Act provides a five year recovery period for any machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) which is used in a farming business and the original use of which commences with the taxpayer. (Code Sec. 168(e)(3)(B), as amended by Act Sec. 505(a) of Division C)

Preparer Penalty Eased

New law. Generally effective for returns prepared after May 25, 2007, the Act revises the definition of an "unreasonable position" and changes the standards for imposition of the tax return preparer penalty. The preparer standard for undisclosed positions is reduced to "substantial authority," which conforms to the taxpayer standard. The preparer standard for disclosed positions is set at "reasonable basis." (Code Sec. 6694(a), as amended by Act Sec. 506(a) of Division C) The preparer standard for reportable transactions, to which Code Sec. 6662A applies (i.e., listed transactions and reportable transactions with significant avoidance or evasion purposes), remains unchanged. For reportable transactions the preparer must have a reasonable belief that the position would more likely than not be sustained on its merits. For reportable transactions, the provision is effective for returns prepared for tax years ending after Oct. 3, 2008.

Energy Tax Breaks in the Emergency Economic Stabilization Act of 2008

Energy Credits Are Extended and Expanded

New law. The Act extends the placed in service date for the 30% credits for solar property, fuel cell property, and microturbine property for eight years, through Dec. 31, 2016. (Code Sec. 48(a)(2)(A)(i)(II), Code Sec. 48(a)(3)(A)(ii), Code Sec. 48(c)(1)(D), Code Sec. 48(c)(2)(D), as amended by Act Sec. 103 of Division B)

Credit can offset AMT. In tax years beginning after Oct. 3, 2008 and for carrybacks of those credits, the Act makes the energy credit allowable against the AMT by adding it to the list of specified credits allowed against the AMT. (Code Sec. 38(c)(4)(B)(v), as amended by Act Sec. 103(b))

Residential Energy Efficient Property Credit Extended and Modified

New law. The Act extends the residential energy efficient property credit for eight years, so that it is available for property placed in service before 2017. (Code Sec. 25D(g), as amended by Act Sec. 106(a)) For tax years beginning after Dec. 31, 2008, the Act removes the $2,000 limitation on the credit allowed for a tax year for qualified solar energy property expenditures. (Code Sec. 25D(b)(1)) To reflect this change, where two or more individuals jointly occupy a dwelling unit and use it as a residence, there is no limit on the amount of qualified solar electric property expenditures that may be taken into account by all the individuals during the calendar year. (Code Sec. 25D(e)(4)(A))

For tax years beginning after 2007, the Act adds two new components to the residential energy efficient property. The credits equal 30% of:

> ... qualified small wind energy property expenditures made by the taxpayer during the tax year, (Code Sec. 25D(a)(4))
>
> ... qualified geothermal heat pump property expenditures made by the taxpayer during the tax year, (Code Sec. 25D(a)(5))

Credit can offset AMT. For tax years beginning after 2007, the Act adds the residential energy efficient property credit to the credits that aren't subject to the Code Sec. 26(a)(1) limitation. (Code Sec. 26(a)(1))

Extension and Modification of Credit for Energy-Efficiency Improvements to Existing Home

New law. The Act extends the $500 tax credit for energy-efficient existing homes for 2009. It provides that the credit doesn't apply to property placed in service (1) after Dec. 31, 2007 and before Jan. 1, 2009; or (2) after Dec. 31, 2009. (Code Sec. 25C(g), as amended by Act Sec. 302(a) of Division B)

> RIA observation: In other words, the credit, which expired for property placed in service after Dec. 31, 2007, now applies to property placed in service after Dec. 31, 2008 and before Jan. 1, 2010.

Plug-in Electric Drive Vehicle Credit

For tax years beginning after Dec. 31, 2008, the Act adds a tax credit for new qualified plug-in electric drive motor vehicles (NQPEDMVs) for property purchased before Jan. 1, 2015. (Code Sec. 30D, as added by Act Sec. 205(a) of Division B) Subject to a limit based on weight, the applicable amount is the sum of: (1) $2,500; plus (2) $417 for each kilowatt hour of traction battery capacity in excess of 6 kilowatt hours. (Code Sec. 30D(a)(2)) The portion of the credit for NQPEDMVs that is attributable to property of a character subject to an allowance for depreciation (generally, property used in a trade or business or for the production of income) is treated as part of the general business credit; the non-depreciable property portion is treated as a personal credit. (Code Sec. 30D(d))

Bicycle Commuters Fringe Benefit

For tax years beginning after Dec. 31, 2008, the Act adds qualified bicycle commuting reimbursement to the list of qualified transportation fringe benefits. (Code Sec. 132(f)(1)(D), as amended by Act Sec. 211(a) of Division B) Qualified bicycle commuting reimbursement are, for any calendar year, any employer reimbursement during the 15-month period beginning with the first day of that calendar year for reasonable expenses incurred by the employee during that calendar year for the purchase of a bicycle and bicycle improvements, repair, and storage. (Code Sec. 132(f)(5)(F)) The benefit is limited to $20 (not adjusted for inflation) multiplied by the number of months during the year that an employee regularly uses a bicycle for a substantial portion of the travel between his residence and his place of employment. Unlike other qualified transportation fringe benefits, qualified bicycle commuting reimbursements can't be used in conjunction with commuter highway vehicle transportation, transit passes, or parking benefits. (Code Sec. 132(f)(5)(F))

First Year 50% Bonus Depreciation for Investments in Recycling

New law. For property placed in service after Aug. 31, 2008, 50% first year bonus depreciation is allowed for qualified reuse and recycling property. The adjusted basis of the property is reduced by the amount of that deduction before computing the amount otherwise allowable as a depreciation deduction for the tax year and any later tax year. (Code Sec. 168(m)(1), as amended by Act Sec. 308(a) of Division B)

Alternative minimum tax (AMT) exemption. For purposes of determining alternative minimum taxable income for qualified reuse and recycling property, neither the 50% bonus depreciation allowable for the property nor any of the other depreciation deductions allowable for the property (in the first year or in later years) are subject to adjustment for AMT purposes, (Code Sec. 168(m)(2)(D))

Qualified reuse and recycling property is any machinery and equipment (not including buildings or real estate), along with any appurtenant property, including software necessary to operate such equipment, which is used exclusively to collect, distribute, or recycle qualified reuse and recyclable materials—scrap plastic, scrap glass, scrap textiles, scrap rubber, scrap packaging, recovered fiber, scrap ferrous and nonferrous metals or electronic scrap (cathode ray tube, flat panel screen or certain video display device, etc.) generated by an individual or business.

Suspension of Limit on Percentage Depletion from Marginal Wells Is Extended

New law. For tax years beginning after Dec. 31, 2008, the Act extends the rule suspending the 100%-of-taxable-income limitation for marginal properties to include any tax year beginning after Dec. 31, '97 and before Jan. 1, 2008, or beginning after Dec. 31, 2008 and before Jan. 1, 2010. (Code Sec. 613A(c)(6)(H), as amended by Act Sec. of Division B)

Brokers Must Report Customer's Adjusted Basis and Character of Gain or Loss

For sales of certain securities acquired after Dec. 31, 2010, the Act provides that every broker that is required to file an information return reporting the gross proceeds of a covered security must include in the return the customer's adjusted basis in the security and whether any gain or loss with respect to the security is short term or long term. Specifically, the Act provides that, if a broker is otherwise required to make a return under Code Sec. 6045(a) with respect to the gross proceeds of the sale of a covered security, the broker must include in the return: (1) the customer's adjusted basis in the security, and (2) whether any gain or loss with respect to the security is long-term or short-term (within the meaning of Code Sec. 1222). (Code Sec. 6045(g), as added by Act Sec. 403(a)(1) of Division B) A covered security includes any share of stock in a corporation; any note, bond, debenture, or other evidence of indebtedness; any commodity, or contract or derivative with respect to the commodity, if IRS determines that adjusted basis reporting is appropriate for purposes of these reporting requirements; and any other financial instrument with respect to which IRS determines that adjusted basis reporting is appropriate for purposes of these rules. (Code Sec. 6045(g)(3)(B))

Additional FUTA Surtax Is Extended Through 2009

New law. The Act provides that the 6.2% FUTA tax rate continues to apply through 2009, and the 6.0% rate applies for calendar year 2010 and later years. (Code Sec. 3301, as amended by Act Sec. 404(a) of Division B) That is, the temporary 0.2% surtax is extended for one year through Dec. 31, 2009.

New Tax Breaks for Victims of Nationwide Disasters in the Emergency Economic Stabilization Act of 2008

Overview of New Tax Breaks for Nationwide Disasters

The Act introduces a new series of tax breaks for disaster victims, all of which relate to a new term in the Code—"a Federally declared disaster." This new term, in Code Sec. 165(h)(3)(C), as amended by Act Sec. Sec. 706(a) of Division C, is defined as "any disaster subsequently determined by the President of the United States to warrant assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act." Additionally, the term "disaster area" is defined as "the area so determined [by the President] to warrant such assistance." The new term comes into play for disasters declared in tax years beginning after Dec. 31, 2007. (Act Sec. 706(d)(1) of Division C)

Eased Casualty Loss Rules

New law. For disasters declared in tax years beginning after 2007, for taxpayers that itemize, the Act waives the 10% of AGI limitation for a "net disaster loss," which is the excess of personal casualty losses attributable to a "Federally declared disaster" occurring before 2010 in a "disaster area," over personal casualty gains. (Code Sec. 165(h)(3), as amended by Act Sec. 706(a) of Division C)

Increase in dollar floor. The Act increases the $100 limitation per casualty to $500, for tax years beginning after 2008 and before 2010. (Code Sec. 165(h)(1), as amended by Act Sec. 706(c)(1))

Expensing of Qualified Disaster Expenses

New law. For amounts paid or incurred after Dec. 31, 2007, with respect to a disaster occurring after that date, the Act allows a taxpayer to elect to treat any qualified disaster expense that is paid or incurred after 2007 by the taxpayer as a deduction for the tax year in which paid or incurred. For this purpose, a qualified disaster expense is any otherwise capitalizable expenditure paid or incurred in connection with a trade or business or with business-related property that is for:

(1) the abatement or control of hazardous substances that were released on account of a Federally declared disaster;

(2) the removal of debris from, or the demolition of structures on, real property damaged or destroyed as a result of a Federally declared disaster; or

(3) the repair of business-related property damaged as a result of a Federally declared disaster. (Code Sec. 198A, as added by Act Sec. 707(a) of Division C)

The Federally declared disaster in (1), (2), or (3) must occur before Jan. 1, 2010. (Code Sec. 198A(b))

Longer Carryback of NOLs Attributable to Federally Declared Disasters

New law. For NOLs for tax years beginning after 2007, in connection with a disaster declared after that date, the Act provides a special five-year carryback period for NOLs to the extent of a qualified disaster loss. (Code Sec. 172(b)(1)(J), as amended by Act Sec. 708(a) of Division C)

Expensing Increased for Qualified Disaster Assistance Property

New law. For property placed in service after Dec. 31, 2007, with respect to disasters declared after that date, the Act provides that the maximum expense amount that can otherwise be deducted under Code Sec. 179 for the tax year is increased by the lesser of: (1) $100,000, or (2) the cost of qualified section 179 disaster assistance property (defined below) placed in service during the tax year. (Code Sec. 179(e)(1)(A), as amended by Act Sec. 711(a) of Division C) Furthermore, the beginning-of-phase-out amount otherwise in effect for the tax year is increased by the lesser of $600,000, or the cost of qualified section 179 disaster assistance property placed in service during the tax year. (Code Sec. 179(e)(1)(B))

Bonus Depreciation for Qualified Disaster Assistance Property

New law. For property placed in service after Dec. 31, 2007, with respect to disasters declared after that date, under the Act, an additional depreciation deduction is allowed in the placed-in-service year equal to 50% of the adjusted basis of “qualified disaster assistance property.” (Code Sec. 168(n), as added by Act Sec. 710(a) of Division C) There is no AMT depreciation adjustment for qualified disaster assistance property recovered under Code Sec. 168(n). (Code Sec. 168(n)(2)(D))

Pension Act waives required minimum distributions for calendar year 2009

New law. Under the Act, no RMD is required for calendar year 2009 from individual retirement plans and employer-provided qualified retirement plans that are defined contribution plans (within the meaning of Code Sec. 414(i)). (Code Sec. 401(a)(9)(H), as amended by Pension Act 201(a)) This applies to:

... a defined contribution plan described in Code Sec. 401(a), or in Code Sec. 403(a) or Code Sec. 403(b),

... a defined contribution plan which is an eligible deferred compensation plan described in Code Sec. 457(b), but only if the plan is maintained by an employer described in Code Sec. 457(e)(1)(A), or

... an individual retirement plan. (Code Sec. 401(a)(9)(H)(i))

Business Tax Changes in the American Recovery and Reinvestment Act of 2009

Following are highlights of the business tax changes in the American Recovery and Reinvestment Act of 2009 (the Recovery Act) signed into law by the President on Feb. 17, 2009.

Additional 50% First-Year Depreciation OK'd for Most Types of New Depreciable Property Placed in Service in 2009

New law. For property placed in service after Dec. 31, 2008, in tax years ending after that date, the Recovery Act provides an additional depreciation deduction in the placed-in-service year equal to 50% of the adjusted basis of “qualified property.” (Code Sec. 168(k)(1), as amended by Act Sec. 1201(a)) The property generally must be acquired before Jan. 1, 2010 and must be placed in service before Jan. 1, 2010 (before Jan. 1, 2011 for certain longer-lived property).

RIA observation: “Qualified property” includes most types of new property other than buildings.

RIA observation: There is no AMT adjustment for the entire recovery period of qualified property.

First-Year Depreciation Dollar Cap for New Passenger Autos Placed in Service in 2009 Raised by $8,000

New law. Retroactively effective for vehicles bought and placed in service after 2008 and before 2010, the Recovery Act increases by $8,000 the first-year depreciation dollar limit for a passenger auto that is “qualified property” meeting the original use and acquisition and placed-in-service requirements (explained above). (Code Sec. 168(k)(2)(F)(i))

Recovery Act Boosts Code Sec. 179 expensing for 2009

New law. For tax years beginning in 2009, the Recovery Act increases the expensing limit to $250,000 and the investment ceiling limit to $800,000. The $250,000 and $800,000 amounts are not indexed for inflation. (Code Sec. 179(b)(7), as amended by Act Sec. 1202)

Small Businesses May Elect Longer NOL Carryback Period

New law. For NOLs arising in tax years ending after Dec. 31, 2007, the Recovery Act permits small businesses to elect to increase the NOL carryback period for an applicable 2008 NOL (the “applicable NOL”) from 2 years to any whole number of years which is more than 2 and less than 6. (Code Sec. 172(b)(1)(H), as amended by Act Sec. 1211(a))

Reduced Estimated Tax Burden in 2009 for Individuals With Small Businesses

New law. Effective on Feb. 17, 2009, the Recovery Act provides that notwithstanding Code Sec. 6654(d)(1)(C), for any tax year beginning in 2009, in computing the amount of the required annual installments of estimated income tax of any qualified individual, “required annual payment” means the lesser of (1) 90% of the tax shown on the return for the tax year, or (2) 90% of the tax shown on the return of the individual for the preceding tax year. (Code Sec. 6654(d)(1)(D), as amended by Act Sec. 1212; Committee Report)

A qualified individual means any individual if the AGI on the tax return for the preceding tax year is less than $500,000 ($250,000 if married filing separately) and the individual certifies that at least 50% of the gross income shown on the return for the preceding tax year was income from a small trade or business. For estates and trusts, AGI is determined under Code Sec. 67(e). A small trade or business is one that employed no more than 500 persons, on average, during the calendar year ending in or with the preceding tax year. (Code Sec. 6654(d)(1)(D))

Exclusion for Qualified Small Business Stock Increased to 75% of Gain

New law. For “qualified small business stock” (QSBS) acquired after Feb. 17, 2009 and before Jan. 1, 2011, the Recovery Act provides that:

... the 50% gain exclusion is increased to 75%, and Code Sec. 1202(a)(3)(A)

... none of the 60% gain exclusion rules for QBE QSBS apply. (Code Sec. 1202(a)(3), as amended by Act Sec. 1241)

S Corporation Built-In Gain Holding Period Shortened Temporarily to Seven Years

Other Changes Affecting Business

Under pre-Act law, for payments made after 2010, the federal government and the government of every state, political subdivision of a state, and instrumentality of a state or state subdivision (including multi-state agencies) making certain payments to a person providing any property or services would have been required to deduct and withhold tax from that payment in an amount equal to 3% of the payment. The Recovery Act delays the implementation of the 3% withholding requirement by one year to apply to payments after Dec. 31, 2011. (Code Sec. 3402(t), as amended by Act Sec. 1511)

Individual Tax Breaks in the American Recovery and Reinvestment Tax Act of 2009

Making Work Pay Credit

New law. The Recovery Act provides eligible individuals with a refundable income tax credit for tax years beginning in 2009 and 2010. (Code Sec. 36A, as added by Act Sec. 1001(a)) The credit is the lesser of (1) 6.2% of an individual's earned income or (2) $400 ($800 for a joint return). (Code Sec. 36A(a))

Economic Recovery Payment to Recipients of Social Security, SSI, Railroad Retirement and Veterans Disability Compensation Benefits

The Recovery Act provides a one-time payment of $250 to retirees, disabled individuals and SSI recipients receiving benefits from the Social Security Administration, Railroad Retirement beneficiaries, and disabled veterans receiving benefits from the U.S. Department of Veterans Affairs. To be entitled to the $250 payment, the individual must have been eligible for one of the four benefit programs for any month during the three-month period ending with the month which ends before the month that includes the Feb. 17, 2009 date of enactment. Thus, to be entitled to the payment, the individual must have been so eligible during November or December of 2008 or January of 2009. (Act Sec. 2201) The one-time payment is a reduction to any allowable Making Work Pay credit (see above). Treasury must begin disbursing economic recovery payments as soon as practicable, but no later than June 17, 2009 (120 days after the Feb. 17, 2009 date of enactment).

Refundable Credit for Certain Federal and State Pensioners

Effective Feb. 17, 2009, the Recovery Act provides a one-time refundable tax credit of $250 in 2009 to certain government retirees who are not eligible for Social Security benefits. (Act Sec. 2202) This one-time credit is a reduction to any allowable Making Work Pay credit (see above).

Increase in Earned Income Tax Credit

New law. The Recovery Act increases the EITC credit percentage for families with three or more qualifying children to 45% for 2009 and 2010. (Code Sec. 32(b)(3), as amended by Act Sec. 1002(a)) For example, in 2009, taxpayers with three or more qualifying children may claim a credit of 45% of earnings up to $12,570, resulting in a maximum credit of $5,656.50.

Refundable Child Credit Eased

New law. The Recovery Act modifies the earned income formula for the determination of the refundable child credit to apply to 15% of earned income in excess of $3,000 for tax years beginning in 2009 and 2010. (Code Sec. 24(d)(4), as amended by Act Sec. 1003(a))

New American Opportunity Tax Credit

New law. The Recovery Act modifies the Hope credit for tax years beginning in 2009 or 2010. (Code Sec. 25A(i), as amended by Act Sec. 1004(a)) The modified credit is referred to as the American opportunity tax credit. The credit is up to $2,500 per eligible student per year for qualified tuition and related expenses paid for each of the first four years of the student's post-secondary education in a degree or certificate program. The modified credit rate is 100% on the first $2,000 of qualified tuition and related expenses, and 25% on the next $2,000 of qualified tuition and related expenses. (Code Sec. 25A(i)(1)) The definition of qualified tuition and related expenses is expanded to include course materials. (Code Sec. 25A(i)(3))

Increased Transit and Vanpool Transportation Fringe Benefits

New law. For months beginning on or after Mar. 1, 2009 and before Jan. 1, 2011, the Recovery Act increases the monthly exclusion for employer-provided transit and vanpool benefits to the same level as the exclusion for employer-provided parking, $230 per month for 2009 (Code Sec. 132(f)(2), as amended by Act Sec. 1151)

Computers as Education Expenses under 529 Plans

New law. Under the Recovery Act, expenses paid or incurred in 2009 or 2010 for the purchase of any computer technology or equipment or Internet access or related services qualify as qualified education expenses under QTPs if such technology, equipment, or services are to be used by the QTP beneficiary or his family during any of the years the beneficiary is enrolled at an eligible educational institution. (Code Sec. 529(e)(3)(A)(iii), as amended by Act Sec. 1005(a)) Expenses for computer software designed for sports, games or hobbies do not qualify under Code Sec. 529(e)(3)(A)(iii) unless the software is predominantly educational in nature. (Code Sec. 529(e)(3)(A)(iii))

First-time Homebuyer Credit Eased

New law. The Recovery Act extends the credit so that it applies to purchases before Dec. 1, 2009. (Code Sec. 36(h), as amended by Act Sec. 1006(a)) In addition, it waives the recapture of the credit for qualifying home purchases after Dec. 31, 2008. This waiver of recapture applies without regard to whether the taxpayer elects to treat the purchase in 2009 as occurring on Dec. 31, 2008, which is allowed by Code Sec. 36(g). If the taxpayer disposes of the home or the home otherwise ceases to be the principal residence of the taxpayer within 36 months from the date of purchase, the pre-Recovery Act rules for recapture of the credit apply. (Code Sec. 36(f)(4)(D)) The Recovery Act also increases the maximum homebuyer credit to $8,000. (Code Sec. 36(b))

Partial Exclusion of Unemployment Compensation

New law. Under the Recovery Act, up to $2,400 of unemployment compensation benefits received in 2009 are excluded from gross income by the recipient. (Code Sec. 85(c), as amended by Act Sec. 1007).

New Temporary Deduction for Sales and Excise Taxes on Car Purchases

New law. For purchases on or after Feb. 17, 2009 and before Jan. 1, 2010, the Recovery Act provides a deduction for qualified motor vehicle taxes. It expands the definition of taxes allowed as a deduction to include qualified motor vehicle taxes paid or accrued within the tax year. (Code Sec. 164, as amended by Act Sec. 1008) The deduction generally is allowed to itemizers. (Code Sec. 164(a)(6)) It also is allowed to those claiming the standard deduction. (Code Sec. 63(c)(1)(E))

Qualified motor vehicle taxes are State or local sales or excise taxes imposed on the purchase of a qualified motor vehicle. (Code Sec. 164(b)(6)(A)) Only taxes on that portion of the qualified motor vehicle's purchase price not exceeding $49,500 may be deducted. (Code Sec. 164(b)(6)(B))

The deduction for qualified motor vehicle taxes is allowed in computing the AMT. (Code Sec. 56(b)(1)(E))

Limited-Time-Only Subsidy for COBRA Continuation Coverage of Unemployed Workers

The Recovery Act provides a 65% subsidy for COBRA continuation premiums for up to 9 months for workers who have been involuntarily terminated, and for their families. This subsidy also applies to health care continuation coverage if required by states for small employers. To qualify for premium assistance, a worker must be involuntarily terminated between Sept. 1, 2008 and Dec. 31, 2009. The subsidy terminates upon offer of any new employer-sponsored health care coverage or Medicare eligibility. Workers who were involuntarily terminated between Sept. 1, 2008 and Feb. 17, 2009, but failed to initially elect COBRA because it was unaffordable, must be given an additional 60 days to elect COBRA and receive the subsidy. Participants must attest that their same-year income will not exceed $125,000 for individuals and $250,000 for families. (Act Sec. 3001) The subsidy is not taxable. (Code Sec. 139C, as added by Act Sec. 3001)

AMT Provisions in the American Recovery and Reinvestment Tax Act of 2009

Following are highlights of the alternative minimum tax (AMT) tax changes in the American Recovery and Reinvestment Act of 2009 (the Recovery Act) signed into law by the President on Feb. 17, 2009.

Boosted AMT Exemption Amounts for 2009

New law. For tax years beginning in 2009, the Recovery Act increases the AMT exemption amounts to:

... $46,700 (up from $46,200 in 2008) for unmarried individuals;

... $70,950 (up from $69,950 in 2008) for married couples filing a joint return and surviving spouses; (Code Sec. 55(d)(1), as amended by Act Sec. 1012(a))

... $35,475 (up from $34,975 in 2008) for married individuals filing separate returns.

RIA observation: The AMT exemption amount for married individuals filing separately is 50% of the AMT exemption amount for joint filers and surviving spouses. Thus, the AMT exemption amount for married individuals filing separately is increased to $35,475 (50% × $70,950) for 2009.

RIA observation: The Recovery Act doesn't tinker with the AMT phaseout rules.

Personal Nonrefundable Credits May Offset AMT and Regular Tax for 2009

New law. For tax years beginning in 2009, the Recovery Act provides that the aggregate amount of nonrefundable personal credits can't exceed the sum of: (1) the taxpayer's regular tax liability for the tax year, reduced by the foreign tax credit, and (2) the AMT. (Code Sec. 26(a)(2), as amended by Act Sec. 1011(a)(1))

RIA observation: Thus, for tax years beginning in 2009, the otherwise allowable nonrefundable personal credits may offset AMT as well as regular tax. The Act accomplished this by extending the AMT offset rule in Code Sec. 26(a)(2) to tax years beginning during 2009.

Alternative Motor Vehicle Credit Allowed Against AMT

New law. For tax years beginning after Dec. 31, 2008, the Recovery Act provides that the alternative motor vehicle credit is a personal credit allowed against the AMT.

Repeal of AMT Limits on Tax Exempt Bonds Issued in 2009 and 2010

New law. For interest on bonds issued after Dec. 31, 2008 and before Jan. 1, 2011, the Recovery Act provides that tax-exempt interest on private activity bonds issued isn't an item of tax preference for purposes of the alternative minimum tax (AMT). (Code Sec. 57(a)(5)(C)(vi), as amended by Act Sec. 1503(a))

Energy Tax Provisions in the American Recovery and Reinvestment Tax Act of 2009

Renewable Electricity Production Credit Is Extended

New law. The Recovery Act generally extends for three years through 2013 (through 2012 for wind facilities) the period during which qualified facilities producing electricity from wind, closed loop biomass, open-loop biomass, geothermal energy, municipal solid waste, and qualified hydropower may be placed in service for purposes of the electricity production credit. The placed-in-service period for marine and hydrokinetic renewable energy resources is extended for two years (through 2013). (Code Sec. 45(d), as amended by Act Sec. 1101(a))

Election of Investment Tax Credit Instead of Production Tax Credit

New law. For facilities placed in service after Dec. 31, 2008, the Recovery Act allows taxpayers to make an election to have qualified property of certain qualified facilities treated as energy property eligible for a 30% investment credit under Code Sec. 48. These qualified facilities are wind facilities placed in service in 2009 through 2012; and the other Code Sec. 45(d) facilities (other than refined or Indian coal facilities or solar facilities) placed in service in 2009 through 2103 that are otherwise eligible for the Code Sec. 45 renewable electricity production tax credit and for which no credit under Code Sec. 45 has been allowed. A taxpayer that elects to treat a facility as energy property can't claim the Code Sec. 45 production credit. Qualified property is tangible property or other tangible property (not including a building or its structural components) for which depreciation (or amortization) is allowable but only if the property is used as an integral part of the qualified facility. (Code Sec. 48(a)(5), as amended by Act Sec. 1102(a)) For example, in the case of a wind facility, only property eligible for 5-year depreciation under Code Sec. 168(e)(3)(b)(vi) is treated as eligible. (Committee Report)

Cap on Small Wind Property Business Energy Credit Is Repealed

New law. For periods after Dec. 31, 2008, the Recovery Act eliminates the credit cap applicable to qualified small wind energy property. (Code Sec. 48(c)(4), as amended by Act Sec. 1103(a)) In applying the effective date, rules similar to those of Code Sec. 48(m) (as in effect on the day before the enactment of the Revenue Reconciliation Act of '90) apply; that is, the increased credit limit applies only to the portion of the basis of qualified property that was constructed, reconstructed, or erected after Dec. 31, 2008.

Energy Credit Basis Reduction Rule for Subsidized Energy Financing Eliminated

New law. For periods after Dec. 31, 2008, the Recovery Act eliminates the rule that reduces the basis of the property for purposes of claiming the credit if the property is financed by subsidized energy financing or with proceeds from private activity bonds. (Code Sec. 48(a)(4)(D), as amended by Act Sec. 1103(b)) In applying the effective date, rules similar to those of Code Sec. 48(m) (as in effect on the day before the enactment of the Revenue Reconciliation Act of '90) apply; that is, the increased credit limit applies only to the portion of the basis of qualified property that was constructed, reconstructed, or erected after Dec. 31, 2008.

Energy Credit and Electricity Production Credit Coordinated With Renewable Energy Grants

New law. For specified energy property with respect to which a grant is made by the Energy Secretary under Sec. 1603 of the Recovery Act, no energy credit is allowed under Code Sec. 48, and no electricity production

credit is allowed under Code Sec. 45 for the specified energy property for the tax year in which the grant is made or any later tax year. (Code Sec. 48(d)(1), as amended by Act Sec. 1104)

RIA observation: Thus, a taxpayer can elect to take either a tax credit or a grant from the Department of Energy for qualifying specified energy property placed in service in a tax year, but not both.

Nonbusiness Homeowners Energy Credit Extended to 2010 and Modified

New law. The Recovery Act extends the Code Sec. 25C nonbusiness energy tax credit for one year through Dec. 31, 2010. (Code Sec. 25C(g)(2), as amended by Act Sec. 1121(e)) For tax years beginning after Dec. 31, 2008, for property placed in service before Jan. 1, 2011, the Recovery Act raises the 10% credit rate to 30%. All energy property otherwise eligible for the $50, $150, and $300 credits is instead eligible for a 30% credit on expenditures for the property. (Code Sec. 25C(a)) In addition, the $500 lifetime cap (and the $200 lifetime cap for windows) is eliminated and replaced with an aggregate cap of $1,500 for property placed in service after Dec. 31, 2008 and before Jan. 1, 2011. (Code Sec. 25C(b)) Effective on Feb. 17, 2009, there are revised standards for energy efficient building property (electric heat pumps, central air conditioners and water heaters), oil furnaces and hot water boilers, and exterior windows, doors, and skylights. For tax years beginning after 2008, a revised standard also applies for stoves using biomass fuels. (Code Sec. 25C(c), Code Sec. 25C(d)) For tax years beginning after Dec. 31, 2008, the limitation on subsidized energy financing is also eliminated. (Code Sec. 25C(e)(1), as amended by Act Sec. 1103(b)(2))

Cap on Residential Energy Efficient Property Credit Eliminated

New law. For tax years beginning after Dec. 31, 2008, the Recovery Act eliminates the credit caps for solar hot water, geothermal, and wind property. (Code Sec. 25D(b), as amended by Act Sec. 1122) The rules covered the treatment of joint occupants are revised to only apply to qualified fuel cell property. (Code Sec. 25D(e)(4)) For tax years beginning after Dec. 31, 2008, the limitation on subsidized energy financing is also eliminated. (Code Sec. 25D(e), as amended by Act Sec. 1103(b))

Alternative Fuel Vehicle Refueling Property Credit Increased for 2009 and 2010

New law. For property placed in service in tax years beginning after Dec. 31, 2008, and before Jan. 1, 2011, the Recovery Act increases the maximum credit available for qualified hydrogen refueling property from $30,000 to $200,000. The Recovery Act also increases the maximum credit available for other (non-hydrogen related) qualified refueling property from $30,000 to $50,000. The credit rate also increases from 30% to 50% for non-hydrogen refueling property. In addition, the maximum credit is increased from $1,000 to $2,000 for QAFVR property installed on property which is used as a principal residence. (Code Sec. 30C(e)(6), as amended by Act Sec. 1123)

Plug-in Electric Motor Vehicle Credit Modified

New law. The Recovery Act creates two new electric vehicle related credits and modifies the existing Code Sec. 30D new qualified plug-in electric drive motor vehicle credit.

Updated Regulations

Final regs on dependent child of divorced or separated parents or parents who live apart

T.D. 9408, 07/01/2008 ; Reg. 1.152-4

IRS has issued final regs on the rules for claiming a child as a dependent by parents who are divorced, legally separated under a decree of separate maintenance or a written separation agreement, or who live apart at all times during the last 6 months of the calendar year. They are effective for tax years beginning after July 2, 2008,

and reflect amendments under the Working Families Tax Relief Act of 2004 (WFTRA) and the Gulf Opportunity Zone Act of 2005 (GOZA).

The final regs update the prior final regs, deleting obsolete provisions, revising language to improve clarity, and incorporating provisions in Reg. § 1.152-4T, which is removed. They also provide guidance on issues that have arisen in the administration of Code Sec. 152(e).

To remedy any ambiguity caused by the proposed regs' failure to define custody, the final regs provide that a child is in the custody of one or both parents for more than one-half of the calendar year if one or both parents have the right under state law to physical custody of the child for more than one-half of the calendar year. But, a child isn't in the custody of either parent for purposes of Code Sec. 152(e) when the child reaches the age of majority under state law. (Reg. 1.152-4(c))

The final regs further provide that a release not on a Form 8332 must be a document executed for the sole purpose of releasing the claim. A court order or decree or a separation agreement cannot serve as the written declaration.

The final regs also clarify that a multiple year written declaration executed in a tax year beginning on or before July 2, 2008, that satisfies the requirements for the form of a written declaration in effect at the time the written declaration was executed is treated as satisfying the requirements for the form of a release under the final regs.

Proposed regs explain strict charitable contribution substantiation & appraisal rules

Preamble to Prop Reg 08/06/2008 ; Prop Reg 1.170A-15, Prop Reg 1.170A-16, Prop Reg 1.170A-17, Prop Reg 1.170A-18

Basic recordkeeping rule. For purposes of the basic recordkeeping rules in Code Sec. 170(f)(17), a monetary gift would include a transfer of a gift card redeemable for cash, and a payment made by credit card, electronic fund transfer, online payment service, or payroll deduction. A bank record would include a statement from a financial institution, an electronic fund transfer receipt, a canceled check, a scanned image of both sides of a canceled check obtained from a bank website, or a credit card statement. Written communication would include electronic mail correspondence. (Prop Reg 1.170A-15(b))

Noncash substantiation requirements. The proposed regs would clarify that donors who make contributions of $250 or more but not more than $500 must obtain only a contemporaneous written acknowledgment, as required by Code Sec. 170(f)(8) and Reg. 1.170A-13(f)), and needn't obtain any other written records. (Prop Reg 1.170A-16(b)) The proposed regs explain in detail how donors making noncash contributions of more than $500 would have to complete Form 8283 (Noncash Charitable Contributions). They also would provide that the rules for substantiation that must be submitted with a return also apply to the return for a carryover year under Code Sec. 170(d). (Prop Reg 1.170A-16(c) through Prop Reg 1.170A-16(f))

Temporary regs explain penalty for failing to report reportable transactions

T.D. 9425, 09/10/2008 ; Reg. 301.6707A-1T ; Preamble to Prop Reg 09/10/2008 ; Prop Reg 301.6707A-1

Temporary regs. Under the temporary regs, a taxpayer may incur a separate penalty under Code Sec. 6707A with respect to each reportable transaction that the taxpayer was required, but failed, to disclose within the time and in the form and manner required under Reg. 1.6011-4(d) and (e) or other published guidance. However, a taxpayer who must disclose a reportable transaction on a Form 8886 (or successor form) filed with a return, amended return, or application for tentative refund and who also must disclose the transaction on a Form 8886 (or successor form) with OTSA, is subject to only a single Code Sec. 6707A penalty for failure to make either one or both of these disclosures. (Reg. 301.6707A-1T(c)) The temporary regs define “reportable transaction” and “listed transaction” by reference to these terms in the Code Sec. 6011 regs. (Reg. 301.6707A-1T(b))

Cases and Rulings

Loan repayment to shareholder's spouse wasn't constructive distribution

Beckley, (2008) 130 TC No. 18

The Tax Court has ruled that payments made by a corporation to the wife of one of its shareholders represented repayment of money she advanced to a predecessor corporation. Despite the absence of a written loan agreement, the repayment wasn't a constructive distribution to the shareholder.

Limited partner's investment interest from trader partnership deductible above-the-line

Rev Rul 2008-38, 2008-31 IRB ; Ann. 2008-65, 2008-31 IRB

Earlier this year, IRS issued Rev Rul 2008-12, 2008-10 IRB 520 concluding that where a noncorporate limited partner doesn't materially participate in the partnership's activity, his distributive share of the interest expense on debt allocable to the entity's trade or business of trading securities is investment interest, subject to the Code Sec. 163(d)(1) deduction limitation. Because it received a number of queries as to where to report such interest, IRS has issued a new revenue ruling amplifying the earlier one and a new announcement clarifying where to report such interest.

Specifically, new Rev Rul 2008-38 provides that, in the case of an individual, interest paid or accrued on debt allocable to property held for investment described in Code Sec. 163(d)(5)(A)(ii) is (to the extent allowable after the application of the Code Sec. 163(d) limitation) a deduction described in Code Sec. 62(a)(1) and is therefore taken into account in determining the individual's adjusted gross income (AGI). New Ann. 2008-65, 2008-31 IRB, clarifies that the limited partner described in Rev Rul 2008-12 properly includes the allowable amount of his distributive share of the trading partnership's interest expense in computing his ordinary business income or loss on Schedule E of his Form 1040.

To the extent that this amount is attributable to debt incurred in PRS's trade or business, the deduction is taken into account in arriving at LP's AGI; to the extent it is attributable to the debt allocable to the stock and bonds held for investment, the deduction is reported as an itemized deduction. When an individual has both investment interest expense attributable to property described in Code Sec. 163(d)(5)(A)(i) and investment interest expense attributable to property described in Code Sec. 163(d)(5)(A)(ii) and his aggregate investment interest expense is greater than his net investment income, he must allocate his net investment income to the two categories of investment interest expenses using a reasonable method of allocation. One reasonable method is to allocate the net investment income to the two categories of investment interest in the same proportion that the amount of investment interest in each category bears to the total amount of investment interest (the pro rata method).

Limited partner denied business deduction for management fees of investment partnership owning business partnerships

Rev. Rul. 2008-39, 2008-31 IRB 252, 07/03/2008

A new ruling concludes that an individual who is a limited partner of an upper-tier partnership (UTP) that holds lower-tier partnerships (LTPs) for the production of income can't deduct as a Code Sec. 162 business expense the management fees paid by the UTP, even if the LTPs are engaged in a trade or business. Instead, the management fees are deductible only as Code Sec. 212 investment expenses. The ruling also concludes that the management fees of the LTPs are taken into account in computing each LTP's taxable income or loss, and the UTP's distributive share of income or loss.

Employment termination leads to taxable distribution of 401(k) plan loan

Michael Leon, et al. (2008), TC Summary Opinion 2008-86

In a Summary Opinion, the Tax Court has held that distributions from a 401(k) plan following an employee's termination were includible in her income and subject to the Code Sec. 72(t) 10% penalty on early distributions. The distributions included the actual distribution of her remaining plan account balance and the deemed distribution of the outstanding balance of a loan from the 401(k) plan. The Court held that the deemed distribution on the default of the loan occurred not on the date of her employment termination, but on the expiration of the 90-day grace period within which she could have repaid the loan.

Writeoff for cost of day-trading course barred by investment seminar deduction disallowance

Carl H. Jones, 131 TC No. 3

The Tax Court has held that a taxpayer who wasn't in the trade or business of day-trading couldn't deduct the cost of attending a day-trading seminar to improve his skills. The seminar costs were subject to the broad investment seminar deduction bar of Code Sec. 274(h)(7).

Ninth Circuit says valid Sec. 83(b) election causes gain on all ISO stock to be recognized for AMT purposes

Kadillak v. Comm., (CA 9 7/29/2008) 102 AFTR 2d ¶2008-5111

The Ninth Circuit has affirmed the Tax Court holding that a taxpayer's Code Sec. 83(b) election on ISO stock was valid and thus required him to recognize as alternative minimum taxable income (AMTI) the excess of both his vested and nonvested stock's fair market value over its exercise price on the exercise date. The Court also joined with the Fifth Circuit in holding that an individual taxpayer's AMT capital losses are subject to the Code Sec. 172(d) and Code Sec. 1211(b) limits, and therefore aren't allowed as an alternative tax net operating loss (ATNOL) deduction.

Second Circuit applies dollar limitations to ISO stock losses in computing AMT

Palahnuk, (CA 2 9/29/2008) 102 AFTR 2d 2008–5339

Second Circuit sustains the Tax Court. Before the Second Circuit, the Palahnuks again contended that, under Code Sec. 56(d), they could fully deduct their capital losses, notwithstanding the limitations on capital loss deductions in Code Sec. 172(c), Code Sec. 172(d) and Code Sec. 1211(b). The Second Circuit rejected this approach and adopted the holding of the Tax Court that (1) the capital loss limitations applicable to the regular tax regime also apply to the AMT regime unless explicitly excepted; (2) net capital losses are effectively excluded from the computation of NOLs under Code Sec. 172(c) and Code Sec. 172(d) ; and (3) Code Sec. 56(d) does not provide an exception to the limitation on deducting net capital losses in Code Sec. 172.

Court rebuffs IRS and allows policyholder to escape gain on demutualization

Eugene A. Fisher et al. v. U.S. (Ct Cl 8/6/2008) 102 AFTR 2d ¶ 2008-5150

The Court of Federal Claims has applied a variation of the open transaction doctrine with the result that a policyholder had no gain to report when it chose a cash option in connection with a demutualization of an insurance company. Under this option, the shares awarded to the policyholder were immediately sold by the company and the proceeds were then paid to the policyholder in cash. IRS said that the policyholder was taxable on the full amount of the gain without being able to allocate any of his basis in the contract to offset the sales

proceeds. The Court allowed the policyholder to use his basis in the contract (which greatly exceeded the amount of the sales proceeds) to fully offset the proceeds and thus to report no gain.

Taxpayer taxed on sale of pledged stock using FIFO method

Rendall, (CA 10 08/05/2008) 102 AFTR 2d ¶ 2008–5146

The Tenth Circuit, affirming the Tax Court, has held that gain on a sale of stock that was pledged for a loan and sold by the lender in satisfaction of the loan was taxable to the individual who pledged the stock. Furthermore, the Appeals Court agreed with the Tax Court that the basis of the stock that was sold had to be determined using the first-in, first-out (FIFO) method, which produced a much larger gain for the taxpayer (who filed jointly with his spouse), rather than the last-in, last-out (LIFO) method, which would have resulted in a smaller gain.

IRS eases tax breaks for children of divorced and separated couples

Rev Proc 2008-48, 2008-36 IRB

In a Revenue Procedure, IRS has described the circumstances under which it will treat a child of parents who are divorced, separated, or living apart as the dependent of both parents for purposes of Code Sec. 105(b) (dealing with employer-provided medical expense reimbursements), Code Sec. 132(h)(2)(B) (dealing with excludable fringe benefits), Code Sec. 213(d)(5) (dealing with deductible medical expenses), Code Sec. 220(d)(2) (dealing with Archer Medical Savings Accounts (MSAs)), and Code Sec. 223(d)(2) (dealing with Health Saving Accounts (HSAs)) when the custodial parent has not released the claim to the exemption for the child under Code Sec. 152(e)(2).

Frequent but sporadic stock trading & longer holding periods result in investor status

Holsinger, TC Memo 2008-191

A new Tax Court case illustrates how difficult it is for a stock market investor to show that his activities rise to the level of a trade or business. Around 289 trades one year and 372 the next by a taxpayer weren't enough to justify trader treatment because they took place in a limited period of time. Additionally, his holding periods demonstrated that he was an investor and not a trader hoping to make money on short-term market swings. As a result, the taxpayer's losses were capital losses, and his expenses were miscellaneous itemized deductions.

Doctor's restitution for insurance fraud deductible under Code Sec. 165(c)(2)

PLR 200834016

IRS has privately ruled that a doctor could not deduct as a business loss restitution payments he made to health insurance companies he defrauded. He could, however, deduct the payments under Code Sec. 165(c)(2) as a loss incurred in a transaction entered into for profit.

Deduction for expenses of raising greyhounds limited by hobby loss rules

Whitecavage, TC Memo 2008-203

The Tax Court has found that a taxpayer's breeding of greyhounds for racing was subject to the hobby loss rules. It concluded that the activity contained elements of personal pleasure or recreation despite the “seemingly inhumane manner” in which it was conducted. Accordingly, the taxpayer's deduction for expenses in excess of racing profits was denied.

Employment related settlement payments taxed in year of receipt

PLR 200836019

IRS has privately ruled that periodic payments from a settlement between a taxpayer and her former employer for alleged nonphysical injuries from a hostile work environment won't be includible in her income until the payments are actually received. The cash equivalency, economic benefit and constructive receipt doctrines did not apply to cause her to be taxed earlier.

Sole owner liable for unpaid payroll taxes

Kandi v. U.S., (CA 9 9/25/08), 102 AFTR 2d ¶2008-5342

The U.S. Court of Appeals for the Ninth Circuit has ruled that the sole owner of a limited liability company (LLC) was personally liable for the LLC's unpaid payroll taxes, even though the Code did not clearly address how LLCs should be taxed.

IRA form's reference to will did not operate to name trust as beneficiary

PLR 200846028

IRS has privately ruled that where an individual completed a form for naming his IRA beneficiary by indicating "as stated in wills," the trust named as beneficiary in his will was not the IRA's beneficiary and the trust's beneficiaries were not the designated beneficiaries of the IRA. IRS reached this result because the IRA beneficiaries were not identifiable under the plan, as required under applicable Code Sec. 401(a)(9) regs.

Long-term relationship & supervisory duties result in worker being treated as employee

Michael Neil McWhorter, TC Memo 2008-263

A new Tax Court case illustrates the potential hazard that companies face when they maintain long-term relationships with independent contractors. Largely on the strength of a four-year relationship, as well as the fact that the individual in question performed services similar to a supervisory employee, the Court held that he was not an independent contractor liable for self-employment tax, but instead an employee of the corporation he performed services for.

Plan funds used to pay prior year medical expenses were subject to early withdrawal penalty

Evers, Bernard W., TC Summary Opinion 2008-140

The Tax Court has sustained IRS's imposition of the 10% additional tax on an early retirement plan distribution. In so doing, it rejected the taxpayers' claim that they satisfied the medical expense exception to the penalty. The Court found that the exception did not apply because the medical expenses were incurred in the year before the distribution.

No deduction for tuition and fees paid to childrens' religious day schools or payments for after-school religious education

Sklar, (CA 9 12/12/2008) 102 AFTR 2d ¶ 2008-5639

The Ninth Circuit, affirming the Tax Court, has held that a husband and wife couldn't claim a charitable contribution deduction for tuition and fees paid to their childrens' Orthodox Jewish Day Schools or for separate payments made for their childrens' after-school religious education classes.

IRS takes liberal stance on how homebuyer credit is allocated between unmarried purchasers

Notice 2009-12, 2009-6 IRB

A new notice provides guidance under Code Sec. 36(b)(1)(C) for allocating the first-time homebuyer credit between unmarried taxpayers. It allows use of any reasonable method and shows how a full credit can be obtained even where one buyer wouldn't qualify for any amount of credit under the phaseout rules.

CCA explains how casual slots player determines wagering gains and losses

EMISC 2008-011

A recent Chief Counsel Advice (CCA) explains how a casual gambler determines wagering gains and losses from slot machine play for tax purposes. Essentially, the CCA allows the taxpayer to net out her gains and losses during a given day of gambling.

Supreme Court OKs payment of plan benefits to designated ex-spouse beneficiary despite her waiver of plan rights

Kennedy v. Plan Adm'r for DuPont Sav. and Inv. Plan, (2009, S Ct)

A unanimous Supreme Court has ruled that a plan administrator properly distributed benefits under an ERISA pension plan to a deceased participant's ex-spouse, as she was the only designated beneficiary, even though she had waived her interest in plan benefits in a divorce decree. Resolving two different splits in the circuits, the Court affirmed a Fifth Circuit decision in favor of the plan.

First Circuit holds that noncompete agreement payment wasn't really for sale of goodwill

Muskat v. U.S., (CA 1 1/29/2009) 103 AFTR 2d ¶2009-418

The Court of Appeals for the First Circuit, affirming a district court, has held that a taxpayer failed to show by “strong proof” that a noncompetition agreement in the sale of his family business was actually intended to purchase his personal goodwill. The Court found that the taxpayer's initial treatment of the noncompete agreement payments as ordinary income was correct and rejected his refund claim based on treating it as a capital asset.

Seventh Circuit classifies computer programmer as an independent contractor

Suskovich v. Anthem Health Plans of Virginia, Inc., (CA 7 1/22/2009) 103 AFTR 2d ¶2009-385

The Court of Appeals for the Seventh Circuit, affirming a district court, has concluded that a computer programmer was an independent contractor and not an employee.

Deduction denied for airline mechanic's travel expenses

David A. Wilbert v. U.S., (CA 7, 1/21/2009) 103 AFTR 2d ¶2009-368

Affirming the Tax Court, the Court of Appeals for the Seventh Circuit has denied travel deductions for an airline mechanic who after being laid off was forced to work at distant, multiple locations under a “bumping” rights rule. The mechanic's situation was no different than that of a construction worker who works at different sites throughout the country.

Attorney fees in opt-out class action lawsuit not taxable to class members or representatives

PLR 200906010

IRS has ruled privately that attorney fees paid in an opt-out class action lawsuit weren't includible in class members' or class representatives' gross income, because no contractual obligation for a fee existed between them and litigating counsel.

Use it or lose it: terminated employees forfeit remaining balance on transit reimbursement accounts

Information Letter 2009-0008 ; Information Letter 2009-0012

IRS's Office of Chief Counsel has recently provided guidance explaining why employees who terminate employment cannot receive any of the balance remaining on their transit reimbursement accounts.

Licensed real estate agent's activities count for PAL qualifying real estate professionals exception

Agarwal, TC Summary Opinion 2009-29

In a Summary Opinion, the Tax Court has held that a licensed real estate agent's activities counted for purposes of the Code Sec. 469 passive loss exception for qualifying real estate professionals. She didn't have to be licensed as a real estate broker to be treated as engaged in the real estate brokerage trade or business. Because she met the material participation standard for qualifying real estate professionals, the agent and her husband could claim losses they incurred on two rental properties they owned.

IRS provides detailed tax guidance for victims of Madoff-type investment schemes

Rev Rul 2009-9, 2009-14 IRB, Rev Proc 2009-20, 2009-14 IRB

Just days after Bernard Madoff's guilty plea, IRS has issued comprehensive guidance for the many investors caught in his notorious Ponzi-style fraud. Overall, the guidance takes an extremely generous, pro-taxpayer position, allowing the losses to be claimed as ordinary losses and even allowing NOLs generated by Madoff-style schemes to be treated as sole proprietorship losses potentially eligible to be carried back 3, 4, or 5 years under a business tax break enacted by the American Recovery and Reinvestment Act of 2009.

WORKING DRAFT FOR PRACTITIONER AND PUBLIC COMMENT 8/14/09

Massachusetts Personal Income Tax Treatment of Certain Criminally Fraudulent Investment Arrangements

Massachusetts Personal Income Tax. The Massachusetts personal income tax statute does not adopt the federal deduction for theft loss under IRC § 165 for individual investors. Thus, the federal rules described in Rev. Rul.

2009-9 and the optional federal safe harbor method for a qualified investor to claim a theft loss deduction under Rev. Proc. 2009-20 are not applicable for Massachusetts personal income tax purposes. In a further departure from federal law, an NOL deduction is not allowable under the Massachusetts personal income tax statute. As a result, Massachusetts does not allow the federal NOL carryback or carryforward.

How $1 million mortgage interest cap applies to partial owner

Internal Legal Memorandum 200911007

A Chief Counsel Advice addresses how the $1 million limitation on aggregate acquisition debt under Code Sec. 163(h)(3)(B)(ii) applies where the taxpayer is a partial owner of a residence for which the total acquisition debt exceeds $1 million. The CCA explains that the amount of interest the taxpayer may deduct is determined by multiplying the amount of interest actually paid by him on his qualified residence by a fraction the numerator of which is $1 million and the denominator of which is the average balance of the outstanding acquisition debt during the year in question.

IRS announces settlement offer for those that voluntarily disclose unreported offshore income

IRS Commissioner Doug Shulman on March 26, 2009 has announced what is in effect a settlement offer for those that voluntarily and timely disclose unreported offshore income. Those meeting the terms of the offer will have to pay back-taxes and interest for six years, and pay either an accuracy or delinquency penalty on all six years. They will also pay a penalty of 20% of the amount in the foreign bank accounts in the year with the highest aggregate account or asset value. In other words, 20% of the highest asset value of an account anytime in the past six years. However, those who come forward on a timely basis will not face criminal prosecution.

IRS now says credit and debit card fees for electronic tax payment are deductible

IR 2009-37

Reassessing its previous position, IRS has concluded that credit and debit card convenience fees charged for paying federal individual income taxes electronically are deductible for taxpayers who itemizes. The fees are deductible as miscellaneous itemized deductions subject to the 2% floor.

IRS Q&As shed some new light on the homebuyer credit

First-Time Homebuyer Credit: Questions and Answers, IRS Web Site

IRS has posted a number of questions and answers (Q&As) on the first-time homebuyer credit on its web site. They are grouped into four categories: basic information; homes purchased in 2008; homes purchased in 2009; and scenarios.

Circular loans from partnership to shareholders to S corporation didn't create basis

Kerzner, TC Memo 2009-76

The Tax Court has held that S corporation shareholders did not make an economic outlay on yearly loans to their S corporation and so they did not acquire a sufficient basis in the indebtedness under Code Sec. 1366(d)(1) to claim the S corporation's losses. In a circular flow of cash, the shareholders used proceeds of loans from their wholly owned partnership to make annual loans of identical amounts to their wholly owned S corporation, while the S corporation then paid equivalent amounts of rent back to the partnership.

Passive rental activity couldn't be grouped with nonpassive activity to offset losses

Senra, TC Memo 2009-79

The Tax Court has held that a husband and wife weren't allowed to group their activities in a C corporation with the husband's activities in a disregarded entity to form an appropriate economic unit that could be treated as a single activity for purposes of measuring gain and loss under the Code Sec. 469 passive activity loss (PAL) rules. The husband's rental activities were passive even if he materially participated in them.

IRS explains the tax treatment of policyholder surrenders and sales of life insurance contracts

Rev Rul 2009-13, 2009-21 IRB

A new revenue ruling provides guidance on the tax treatment of surrenders and sales of life insurance contracts in a variety of situations.

New guidance for investors who purchase life insurance contracts

Rev Rul 2009-14, 2009-21 IRB

A new revenue ruling explains the tax treatment to investors who purchase a term life insurance contract and receive death benefits on the contract or proceeds from its sale.

No IRA modification penalty where additional funds withdrawn for education

Benz, (2009) 132 TC No. 15

Rebuffing IRS, the Tax Court has held that a distribution from an IRA for education was not a modification of a taxpayer's prior election to receive a series of substantially equal periodic payments from that IRA. Accordingly, it rejected IRS's attempt to impose the penalty that would have applied had the taxpayer made an impermissible modification.

Partner's amended individual return didn't qualify as administrative adjustment request

Samueli, (2009) 132 TC No. 16

The Tax Court has held that taxpayers' amended individual return didn't qualify as an administrative adjustment request (AAR) under the uniform partnership audit rules. The taxpayers failed to meet the requirements in the regs, and, as a result, the adjustments remained partnership items.

Refinancing of plan loan causes taxable deemed distribution subject to 10% additional tax

Marquez, TC Summary Opinion 2009-80

In a case that illustrates a pitfall of refinancing a plan loan, the Tax Court has found that a taxpayer who refinanced an outstanding plan loan had a taxable deemed distribution subject to the 10% additional tax. Both the original and refinanced loans were treated as outstanding on the date of the refinancing with the result that the maximum loan limitation for the taxpayer was exceeded.

Sale of excess lots by taxpayers building own home resulted in capital gain and loss

Rice, TC Memo 2009-142

The Tax Court has held that where a husband and wife purchased a parcel of property containing a number of lots to build a home and then sold the property they didn't need, those excess lots were held for investment purposes and the proceeds of their sale resulted in capital gains and losses. The excess lots weren't held primarily for sale to customers in the ordinary course of business and their sale didn't result in ordinary income.

Payments benefitting homeowners under HAMP aren't taxable

Rev Rul 2009-19, 2009-28 IRB

A new revenue ruling concludes that Pay-for-Performance Success Payments benefitting a homeowner under the Home Affordable Modification Program (HAMP) are excludable from income under the general welfare exclusion.

Noncustodial parent not allowed child dependency exemption with conditional release

Chief Counsel Advice 200925041

In a Chief Counsel Advice (CCA), IRS has clarified that a divorce decree or separation agreement that allows a noncustodial parent to claim an exemption for a child only if a condition is met doesn't conform to the substance of Form 8332 Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent, and can't be used by a noncustodial parent to substantiate a dependency exemption for a child. This is the case even if it's accompanied by a statement intended to show that the condition in the decree or agreement was met.

Interests in LLPs and LLCs weren't presumptively passive under PAL rules

Garnett (2009), 132 TC No. 19

The Tax Court has held that taxpayers didn't hold their interests in limited liability partnerships (LLPs) and limited liability companies (LLCs) as “limited partners” for purposes of the special Code Sec. 469(h)(2) material participation provision under the passive activity loss rules. That special provision treats losses from an “interest in a limited partnership as a limited partner” as presumptively passive.

LLC interest wasn't equivalent to a limited partnership interest for PAL purposes

Thompson v. U.S., (Ct Fed Cl 7/20/2009) 104 AFTR 2d ¶2009-5124

In a case of first impression for it, the Court of Federal Claims decisively rejected IRS's view that a taxpayer's interest in a limited liability company (LLC) should be treated as a limited partnership interest for purposes of the Code Sec. 469 passive activity loss (PAL) rules. The Court concluded that the LLC wasn't a partnership under state law and couldn't be treated as the equivalent of a limited partnership for PAL purposes. It also suggested that limited liability wasn't the determining factor in deciding whether a taxpayer's interest in an activity is passive; rather, Congress' primary concern was the level of involvement in the activity.

Same-sex couple wasn't entitled to joint filing status

Merrill, TC Memo 2009-166

The Tax Court has held that a same sex couple was not entitled to joint filing status.

IRS confirms that gain on ETFs invested in precious metals is collectibles gain

Some investors are convinced that one way to hedge their bets against further shakiness in the financial markets is to invest in a precious metal. The most convenient way to make this sort of investment is through an exchange traded fund (ETF) that holds the metal. A memo issued by IRS's Chief Counsel Office in 2008, but only made available recently on IRS's website (under a new document category called “Legal Advice Issued to Program Managers”), confirms that ETFs that directly invest in precious metals will generate collectibles gain or loss to their investors.

Cost of doctorate in psychology not deductible as education expense

Ortega, TC Summary Opinion 2009-120

In a Summary Opinion, the Tax Court has held that a mental health practitioner and psychological assistant couldn't deduct the cost of getting a doctorate in psychology. Although she worked in the field of psychology both before and after incurring the expenses, the degree qualified her for a new trade or business as a licensed psychologist.

Tax Court holds basis overstatement isn't omission of income for 6-year limitations period

Beard, TC Memo 2009-184

The Tax Court has again held that an overstatement of basis is not an omission of gross income for purposes of the 6-year limitations period of Code Sec. 6501(e)(1)(A).

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