



Insight Paper # 02:

Second Quarter 2009 Federal Tax Developments

The second quarter of 2009 saw significant federal tax developments from the White House, Congress and the IRS. Many of the developments relate to temporary tax breaks in the *American Recovery and Reinvestment Act of 2009 (2009 Recovery Act)*, which Congress passed in February to help revive the U.S. economy. The IRS also issued important guidance for individuals, businesses and pension plans. This letter describes some of the more important federal tax developments in the second quarter of 2009.

Making Work Pay credit. Many wage earners are seeing an increase in their tax-home pay because of the Making Work Pay credit. Employers started using new withholding tables reflecting the credit in April. However, individuals with multiple jobs and some pension recipients may discover they had too little tax withheld when they file their 2009 returns in 2010. In May, the IRS issued a withholding option for pension plans to offset the Making Work Pay credit. The IRS also reminded individuals with more than one job to adjust their withholding. *CCH Federal Tax Weekly, No. 21, May 21, 2009; CCH Federal Tax Weekly, No. 26, June 25, 2009.*

Cash for clunkers. You have likely heard about a new federal program to encourage people to trade-in old "clunkers" for new fuel efficient vehicles. Consumers will be eligible for tax-free vouchers of either \$3,500 or \$4,500 toward the purchase or lease of a new, more fuel-efficient vehicle. Neither the consumer nor the dealer will recognize taxable income as the result of the voucher. The amount of the voucher generally depends on the type of vehicle purchased and the difference in fuel economy between the purchased vehicle and the trade-in vehicle. You will not receive a paper or electronic voucher. Rather, vouchers will be applied by participating dealers, reducing the purchase price. The cash for clunkers program began on July 1, 2009 and will end on November 1, 2009 or whenever the funds are exhausted, whichever comes first. On July 31, the House approved a \$2 billion infusion to keep the program running amidst high demand. *CCH Federal Tax Weekly, No. 26, June 25, 2009; CCH Federal Tax Weekly, No. 31, August 6, 2009.*

First-time homebuyer credit. In April, the IRS reminded taxpayers that they cannot claim the first-time homebuyer tax credit in anticipation of a future purchase. Taxpayers qualify for the credit when they finalize the purchase of their home, which for most purchasers occurs at the time of the closing, the IRS explained. The first-time homebuyer credit reaches \$8,000 for purchases between January 1, 2009 and November 30, 2009. Taxpayers must be qualified buyers and satisfy income requirements. *CCH Federal Tax Weekly, No. 16, April 16, 2009.*



In good news for home buyers, the U.S. Department of Housing and Urban Development (HUD) will allow taxpayers to monetize the first-time homebuyer credit. Taxpayers financing through a state housing agency and other HUD - approved tax credit advance programs monetize 100-percent of the down payment. Taxpayers using Federal Housing Administration (FHA) lenders can apply the credit to closing costs or make a larger down payment above the FHA-required 3.5-percent minimum. *CCH Federal Tax Weekly, No. 23, June 4, 2009.*

Motor vehicle sales tax deduction. Taxpayers in states without a sales tax can deduct other fees to take advantage of the temporary motor vehicle sales tax deduction. The motor vehicle sales tax deduction is a temporary incentive created by the 2009 Recovery Act. The amount of the deduction is limited to the portion of the state sales or excise tax imposed on the first \$49,500 of the purchase price of the vehicle. According to the IRS, Congress intended for all taxpayers and not just taxpayers in states with a sales tax to benefit from the incentive. *CCH Federal Tax Weekly, No. 25, June 18, 2009.*

Convenience fees. Taxpayers may deduct convenience fees charged for paying individual income taxes electronically by credit or debit cards. The convenience fees are deductible in the tax year in which they are paid as a miscellaneous itemized deduction subject to the two percent of adjusted gross income (AGI) floor. This treatment, the IRS explained, is only available to individuals who itemize their deductions will be able to take advantage of the change. Taxpayers must have sufficient miscellaneous expenses to exceed two percent of their AGI. *CCH Federal Tax Weekly, No. 16, April 16, 2009.*

COBRA premium assistance. Individuals involuntarily terminated from employment between September 1, 2008, and December 31, 2009 may qualify for nine months of COBRA premium assistance under the 2009 Recovery Act. Some family members who are qualified beneficiaries may also be eligible for the subsidy. Individuals pay 35 percent of the COBRA premium and employers must treat that as full payment. Employers claim a credit for the other 65 percent of the premium on their payroll tax returns. Since Congress enacted the COBRA subsidy, the IRS has issued guidance on who qualifies for premium assistance, involuntary termination and the payroll credit. *CCH Federal Tax Weekly, No. 15, April 9, 2009; CCH Federal Tax Weekly, No. 24, June 11, 2009.*

Tax legislation. President Barack Obama released details of his tax proposals in May. President Obama called for extensive reform of the international tax rules, higher tax rates on upper income individuals, extended middle income tax breaks, and deficit reduction. Individual tax cuts would total \$736.5 billion over 10 years and business tax cuts would total \$71 billion over 10 years. Congress has already signaled its opposition to some of the president's proposals, most notably a permanent extension of the Making Work Pay credit. *CCH Federal Tax Weekly, No. 20, May 14, 2009.*



International reforms. The president's international reforms are also controversial. Along with deferring a deduction of expenses related to deferred income, the president has called for reforming the foreign tax credit, limiting the shifting of income through intangible property transfers, limiting earnings stripping by expatriated entities, preventing repatriation of earnings in certain cross-border reorganizations, and repealing the current 80/20 company rules. Existing check-the-box rules would also be overhauled to curb abuses. *CCH Federal Tax Weekly, No. 20, May 14, 2009.*

Vehicle depreciation dollar limits. The IRS issued the depreciation limits for business automobiles, trucks and vans first placed in service in 2009 as well as the annual income inclusion amounts for vehicles first leased in 2009. The 2009 depreciation limits for passenger automobiles are the same as the 2008 limits while the depreciation limits for trucks and vans are lower than the 2008 limits. The IRS also described the additional first year depreciation deduction provided by 2009 Recovery Act. *CCH Federal Tax Weekly, No. 16, April 16, 2009.*

Cell phones. Twenty years ago, the government imposed tough documentation requirements for employer-provided cell phones. At that time, cell phones were new and very expensive. The IRS was concerned about abuses. Today, cell phones are everywhere and both the price of phones and calling costs have fallen dramatically. The IRS announced that it will revisit the documentation rules. Contrary to some news reports, IRS Commissioner Douglas Shulman said that the agency is not "cracking down" on employer-provided cell phones but is trying to make the rules less burdensome on employers and employees. *CCH Federal Tax Weekly, No. 24, June 11, 2009.*

NOL carryback. The 2009 Recovery Act provided an extended carryback net operating loss (NOL) period for certain small businesses. After Congress passed the 2009 Recovery Act, the IRS announced that taxpayers had a limited window to revoke a previous NOL election to take advantage of the new law. In April, the IRS gave taxpayers a "second chance" if they missed the deadline. The IRS also streamlined its procedures. *CCH Federal Tax Weekly, No. 18, April 30, 2009.*

401(k)/403(b) contributions. The IRS issued regulations in May to allow employers suffering from the recession to reduce or suspend safe harbor nonelective contributions to a 401(k) plan or a 403(b) plan (tax-sheltered annuity). The regulations give plans the option to suspend or reduce nonelective contributions, similar to the option to suspend or reduce matching contributions. Employees must be notified in advance of employer actions. *CCH Federal Tax Weekly, No. 21, May 21, 2009.*

Life settlements. The IRS provided guidance on the taxation of insurance proceeds to an investor who purchased the insurance policy for profit. The IRS also addressed the taxation of proceeds to an investor who acquires the policy and then resells it to another investor. The guidance helps to bring clarity to an area that had been uncertain in the past. *CCH Federal Tax Weekly, No. 19, May 7, 2009.*



Tax evasion. The IRS is undertaking a major initiative to encourage taxpayers to disclose unreported foreign bank accounts and assets. In exchange for full disclosure, the IRS will agree not to criminally prosecute tax evaders. Taxpayers must pay all back taxes plus interest and penalties, although the IRS will waive the 75 percent fraud penalty. The settlement offer is temporary and is only available through mid-September 2009. *CCH Federal Tax Weekly, No. 14, April 2, 2009; CCH Federal Tax Weekly, No. 20, May 14, 2009.*

The IRS also warned it is closely reviewing amended returns reporting increases in income to discover taxpayers making "quiet disclosures" of unreported offshore income. Filing an amended return is not the same as participating in the settlement program, the IRS cautioned. *CCH Federal Tax Weekly, No. 20, May 14, 2009.*

If you have any questions about these or any federal tax developments, please contact our office.

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