July 2009

Dear Client:

The following is a summary of the most important tax developments that have occurred in the past three months that may affect you, your family, your investments, and your livelihood. Please call us for more information about any of these developments and what steps you should implement to take advantage of favorable developments and to minimize the impact of those that are unfavorable.

New cash-for-clunkers law.

The President recently signed legislation into law that gives a cash incentive for individuals and businesses to trade in older gas-hogging vehicles for new, more fuel-efficient ones. The incentive takes the form of a voucher of $3,500 or $4,500 depending on the type of vehicle traded in and the fuel efficiency of the vehicle purchased. The new vehicle would have to be purchased between July 1 and November 1 of 2009. The $3,500 or $4,500 vouchers are not be treated as gross income for purposes of the Internal Revenue Code, or for federal or state assistance programs.

Guidance on the limited subsidy for COBRA continuation coverage of unemployed workers.

The American Recovery and Reinvestment Act of 2009 (ARRA) 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. In most instances the employer advances the 65% subsidy to the health plan and then is made whole by way of a payroll tax credit. To qualify for premium assistance, a worker must be involuntarily terminated between Sept. 1, 2008 and Dec. 31, 2009. The subsidy is not taxable when received, but higher income recipients—those with modified adjusted gross income above $125,000 ($250,000 for joint filers)—will have to pay back part or all of it at tax return time. This subsidy has been the subject of much guidance including the following:

- In early May, the IRS posted Q&As on its web site providing additional guidance on recovery of the COBRA premium subsidy by way of a payroll credit claimed on Form 941, and clarifying when the subsidy begins and ends.

- In late May, the Department of Labor released a form that terminated workers (or their qualifying family members) can use to request expedited review of their being denied the COBRA premium subsidy.

- In early June, the IRS added 19 new Q&As affirming that the premium subsidy will not be reported to the IRS or the recipients on either Form W-2 or Form 1099 and shedding additional light on a number of key topics, such as events treated as involuntary termination for COBRA subsidy purposes, who claims the payroll tax credit for the premium subsidy, and recordkeeping requirements.

IRA rollover pitfall to avoid.
Subject to exceptions, withdrawing funds from an IRS before reaching age 59 1/2 triggers a 10% penalty. One way to avoid the penalty is to take a series of substantially equal periodic payments (not less frequently than annually) for the life (or life expectancy) of the IRA owner or the joint lives (or joint life expectancies) of the IRA owner and his designated beneficiary. An individual took advantage of this exception but moved her IRA funds out of equities and into safer certificates of deposit at another institution after the market soured. Unfortunately, in a private ruling, the IRS said that this move triggered the 10% penalty for all years going back to when she started taking the periodic payments. The IRS said that the rollover of the IRA to the new institution was a modification of the periodic payments that triggered imposition of the back penalties under a so-called recapture rule. It didn't matter that the move was inspired by safety concerns or that the individual was willing to take the payments out of the new IRA. Nor would the IRS allow her to correct the situation by placing the funds back into the original IRA. Another taxpayer who took advantage of the periodic payment exception fared better in court. She took additional funds out for her son's education.

The IRS said that this was a modification triggering recapture of the penalty. However, the Tax Court said there is no penalty because there is another exception for IRA funds withdrawn before age 59 1/2 for education and the rules allow an individual to qualify for more than one exception at the same time.

FAQs explain the IRS's settlement offer on unreported offshore income.
Back in May, the IRS posted to its web site 30 frequently asked questions (FAQs) explaining in detail what is, in effect, a settlement offer for those that voluntarily and timely disclose unreported offshore income. The FAQs illustrate how the offer works, explain who may participate in it, outline how to participate and the steps that should be taken, and warn of the potential consequences of failing to take the offer. Additionally, the FAQs address the issue of taxpayers attempting to come clean on unreported offshore income by way of “quiet disclosure” (filing amended returns). In June, the IRS posted an additional 21 FAQs explaining the workings of the 6-year lookback period under the offer, the 20% penalty and how interest accrues, and the options for those who are noncompliant with FBAR (Report of Foreign Bank and Financial Accounts) reporting responsibilities.

Good news for claiming motor vehicle sales tax deduction.
For 2009, there is a new deduction for state and local sales and excise taxes paid on the purchase of new cars, light trucks, motor homes and motorcycles after Feb. 16, 2009 and before Jan. 1, 2010. The deduction generally is available regardless of whether you itemize deductions on Schedule A or claim the standard deduction. The deduction is limited to the tax on up to $49,500 of the purchase price of an eligible motor vehicle. This is one area where there is good news from the IRS—an IRS spokesperson says that the dollar limitation is imposed on a per vehicle basis. This means that you can deduct taxes on two or more purchases of qualifying motor vehicles, up to the limit on each one. The IRS has also stressed that qualifying motor vehicle purchases made in states without a sales tax, such as Alaska, Delaware, Hawaii, Montana, New Hampshire and Oregon, can also qualify for the deduction. Taxpayers who purchase a new motor vehicle in states that do not have state sales taxes are entitled to deduct other fees or taxes

imposed by the state or local government. The fees or taxes that qualify must be assessed on the purchase of the vehicle and must be based on the vehicle's sales price or as a per unit fee.

IRS explains ARRA rules for electing to forgo bonus depreciation to gain refundable credits.
A new revenue procedure explains the changes made by ARRA to the provision that allows corporations to elect not to claim 50% additional first year depreciation deduction for certain property placed in service generally before Jan. 1, 2010, and instead to increase their business credit limit and alternative minimum tax (AMT) credit limit. The revenue procedure, which was effective June 30, 2009, provides guidance to corporations regarding the property eligible for this election, how and when to make the election, and the computation of the amount by which the business credit limitation and AMT credit limitation may be increased if the election is or is not made.

Business cell phone substantiation may be eased.
An employee may exclude from gross income the business use of an employer-provided cell phone as a working condition fringe benefit. However, because cell phones are so-called listed property, strict substantiation requirements must be satisfied for business cell phone usage to qualify for the exclusion. Moreover, any personal usage of an employer-provided cell phone is a taxable fringe benefit. Thus, the current rules require documentation of the business and personal use of the cell phone. Fortunately, relief may be on the way. The IRS is considering three alternative methods to simplify the substantiation requirements applicable to employee usage of employer-provided cell phones: a minimal personal use method, a safe harbor substantiation method, and a statistical sampling method (or a combination of the foregoing).

New guidance on life settlements.
Until recently, individuals who no longer needed a life insurance policy had few options. In general, they could surrender the policy to the issuing insurance company for its cash surrender value or they could stop paying the premiums and let the policy lapse. For a term insurance or other policy without cash surrender value, the only choice was to let the policy lapse. Now, for some individuals, there is a secondary insurance market in which they may be able to sell a policy for more than its cash surrender value or even sell a policy without cash surrender value, such as a term policy. These transactions are called life settlements. The IRS recently lifted some of the uncertainty surrounding life settlements by explaining their tax consequences. This is important for anyone contemplating a life settlement because they will now be in a position to gauge how much they will be left with after tax once they reach an agreement on the settlement amount and fees.