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CPA Client Bulletin, February 2010

American Institute of Certified Public Accountants (AICPA)

CPA Client Bulletin

Smart Tax, Business & Planning Ideas *from your* Trusted Business Advisor[sm]

February 2010

What's Inside

Tax Savings Alert

Now there's a home buyers tax credit for those who have already owned a home.

Home Buyer's Tax Credit Is Extended, Expanded

A tax credit offered to home buyers was extended and expanded in The Worker, Homeownership, and Business Assistance Act of 2009 (WHBA Act), so more buyers may be able to use it to cut their tax bill. If you act soon, you can use this credit to retroactively trim the tax you owe on your 2009 tax return.

A five month extension

Under the American Recovery and Reinvestment Act of 2009, home buyers who had not owned and lived in a house for the previous three years were entitled to a tax credit of 10% of the purchase price of a new home, up to $8,000 (see *CPA Client Bulletin*, May 2009). That provision was scheduled to expire after November 30, 2009.

The WHBA Act extended the time period for eligible purchases. If you have a binding contract signed before May 1, 2010, you may qualify for the tax credit. The contract must call for a closing before July 1, 2010, and you must close by then.

"Old" home buyers, too

While the $8,000 tax credit described previously was and is still for "new" home buyers, the new law creates another tax credit. This one tops out at $6,500. To qualify, the home buyer must have owned and lived in the same home for at least five consecutive years during the eight years before the new residence is purchased.

Example 1: Jim Collins owned a home from January 2002–June 2008. He sold that home and moved into a new one in July 2008. In March 2010, Jim buys a new home.

Jim does not qualify for the $8,000 tax credit because he has owned a home for several years, up to the time of his 2010 purchase. He is not a new home buyer.

However, Jim qualifies as a "long-time resident" under the new law. During the eight years before his current purchase (March 2002–March 2010), Jim lived in the same house for six years and three months. That exceeds the five-year requirement, so Jim may qualify for the $6,500 tax credit.

Whereas the tax credit for new home buyers may benefit young singles and married couples, the smaller credit for long-term residents has a much wider scope. Families can use the $6,500 credit to help them buy a larger home. Retirees can use it to trade down to a smaller place or relocate to another area.

Read the fine print

For either the $8,000 credit (after November 6, 2009) or the $6,500 tax credit, single

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taxpayers must have modified adjusted gross income (MAGI) of no more than $125,000, with a phaseout up to $145,000. For married couples filing joint returns, the phaseout range is $225,000–$245,000. For purchases before November 7, 2009, the phaseout levels remain unchanged ($75,000–$95,000 for singles, $150,000–$170,000 for married filing jointly).

Regardless of income, a taxpayer (or a taxpayer's spouse) must be at least 18 years old on the purchase date to claim either credit. Dependents of another taxpayer can't take a credit, and buyers won't get a tax credit for purchasing a home from a relative. For all taxpayers, no credit is available on homes costing more than $800,000.

The tax credits are available only for the purchase of a principal residence. A taxpayer who ceases to use the home as a principal residence within 36 months of the purchase will have to repay the tax savings to the federal government.

Tax credit carryback

If you make a qualifying purchase in 2010, you might be able to get a tax break in 2009. The new law allows this year's buyers to set the purchase date at December 31, 2009.

Example 2: Lynn Parker buys a home on March 10, 2010. Her purchase qualifies for the $8,000 tax credit. On April 15, 2010, Lynn files her 2009 tax return and reports a home purchase for that year. Therefore, Lynn can claim an $8,000 tax credit on her 2009 return rather than waiting a year to claim the credit on her 2010 tax return. Lynn must attach a copy of the settlement agreement to her tax return to claim the credit, a procedure all taxpayers must follow; the IRS will treat a 2010 date as if it were December 31, 2009. ■

More Gains From Business Losses

The Worker, Homeownership, and Business Assistance Act of 2009 (WHBA Act) expanded another tax break created by last year's American Recovery and Reinvestment Act of 2009 (Recovery Act). Now, more businesses will be able to use more net operating losses to recover tax paid in previous years.

Old to new to newer

The tax code permits a company with a net operating loss (NOL) to carry back that loss to the prior two taxable years. The company can apply the NOL to taxable income from prior years and recover income tax it paid. If the NOL exceeds the taxable income from those two years, the excess NOL can be carried forward for up to 20 years, reducing taxable income and the resulting income tax. As mentioned, two recent tax laws have enhanced the use of NOLs:

- The Recovery Act allowed companies with gross receipts of $15 million or less to carry back a 2008 NOL to the previous five years rather than the previous two years.
- Under the WHBA Act, most U.S. businesses can use the five-year carryback. Only companies that received federal assistance from the Troubled Asset Relief ("bailout") Program are ineligible for the extension. This provision of the WHBA Act may be used for NOLs from 2008 or 2009; in some circumstances, NOLs from both years qualify for the extended carryback.

Setting the limits

As mentioned, the new law allows NOL carrybacks up to five years for losses incurred in 2008 or 2009. However, losses carried back to the fifth year are limited to 50% of that year's income.

Example: ABC Corp. had a $20 million NOL in 2009. The company elects to carry back the loss for five years, to 2004. ABC's taxable income in 2004 was $24 million, so only $12 million of the NOL (50% of $24 million) can be used for that year. The $8 million balance of the NOL can be used to offset taxable income from 2005, 2006, and so forth, while any NOLs still not used can be carried forward.

For most companies, the five-year carryback can be used only once, with either a 2008 or 2009 NOL. However, small companies (no more than $15 million of revenue) that already have used an extended NOL carryback for a 2008 loss, as provided by the Recovery Act, also can carry back a 2009 loss for up to five years, under the WHBA Act. (The 50% limit to fifth-year carrybacks applies to refunds claimed under the newer WHBA Act but not to claims under the Recovery Act.) ■

Did You Know?

Sales of new one-family houses in October 2009 were at a seasonally adjusted annual rate of 430,000. This was 6.2% above the September 2009 rate and 5.1% above the sales rate in October 2008. Over the last 12 months, the number of new houses for sale fell from 380,000 to 239,000.

Source: www.census.gov

Good Reasons for Roth IRA Conversions

Starting in 2010, anyone with a traditional IRA can convert all or part of it to a Roth IRA. Once you have had a Roth IRA for at least five years and after you are age 59½, all withdrawals are tax free.

You'll owe income tax on a Roth IRA conversion. If you convert in 2010 you can elect to defer the tax payments to 2011 and 2012, as explained in the November 2009 *CPA Client Bulletin*. Even with this deferral, you probably will pay income tax much sooner than you would have paid if you had kept the money in a traditional IRA. Why would you want to accelerate those tax payments? Here are some possible reasons:

Estate planning

You are not required to take any withdrawals from a Roth IRA, no matter how old you are. With traditional IRAs, you generally must take at least required minimum distributions (RMDs) after age 70½. Therefore, a Roth IRA can be ideal if you have ample wealth from other sources and wish to pass a tax-free account to your heirs.

Example 1: Barbara Johnson has $1 million in a traditional IRA. She converts the account to a Roth IRA in 2010 and owes $350,000 in income tax, at a 35% rate. Barbara pays that tax bill with non-IRA funds.

Assume that Barbara lives for 24 more years. She earns 6% per year in her Roth IRA and takes no distributions. Therefore, the account is worth around $4 million at Barbara's death. If Barbara's son Phil is the beneficiary of the Roth IRA, he will be subject to an RMD schedule, but all of his withdrawals will be tax free.

Tax tactics

When you convert a traditional IRA to a Roth IRA, you will have to recognize income from the conversion. That income may help you use up tax benefits that otherwise would be used later or not at all. Tax benefits that may expire for lack of income include net operating losses, ordinary losses, and charitable contributions.

Example 2: Nick Patterson is a retiree with modest taxable income. A few years ago, he made a large donation to his alma mater. Under the tax code, Nick's charitable deductions each year are limited to 50% of his income. If Nick doesn't use all of his deductions within five years after the year of the donation, he will never be able to use them.

Therefore, Nick converts his traditional IRA to a Roth IRA. This move increases his income, enabling him to use the balance of his charitable deduction. Thus, Nick has converted his tax-deferred traditional IRA to a potentially tax-free Roth IRA while incurring a relatively low tax obligation.

Market timing

If your traditional IRA loses value, you will owe less tax on a Roth IRA conversion. Many taxpayers invest IRA money in stocks. Because the broad U.S. stock market is currently about 30% below its peak, Roth IRA conversions are relatively inexpensive.

Example 3: Robin Bradley's traditional IRA was worth $300,000 in late 2007. In her 33% tax bracket, Robin would have paid $99,000 in federal income tax to convert this IRA to a Roth IRA.

Robin's traditional IRA is now worth only $210,000. She would owe $69,300 on a Roth IRA conversion, at a 33% tax rate: $29,700 less than a conversion would have cost in 2007. If Robin's Roth IRA grows back to $300,000, she eventually can withdraw that $90,000 without owing any income tax. Without a Roth IRA conversion, Robin would owe income tax on withdrawals from her traditional IRA, making that $90,000 gain taxable.

Retirement planning

Some taxpayers believe they will be in a higher tax bracket in retirement than they are now. They may have low taxable income this year, for example, or they may plan to relocate to a high

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Trusted Advice

A New Era in Roth IRAs

- Starting in 2010, everyone can convert a traditional IRA to a Roth IRA, regardless of income.
- You will owe income tax on a Roth IRA conversion.
- After five years and after you reach age 59½, all Roth IRA distributions are tax free.
- To make a Roth IRA conversion most successful, you should pay the tax with non-IRA funds. Doing so will avoid reducing the account and maximize potential tax-free growth.

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income tax state. In addition, many people fear that future income tax rates will be higher than today's rates because the federal government will need more money to cover its obligations.

In such circumstances, you might want to convert all or part of your traditional IRA to a Roth IRA now and pay tax at current rates. Once you meet the five year and age 59½ tests, you will have a source of tax-free cash no matter what happens to your personal tax rate. ■

TAX CALENDAR

FEBRUARY 2010

February 1

All businesses. Give annual information statements (Forms 1099) to recipients of certain payments you made during 2009. Payments that are covered include: (1) compensation for workers who are not considered employees; (2) dividends and other corporate distributions; (3) interest; (4) rents; (5) royalties;(6) profit-sharing distributions; (7) retirement plan distributions; (8) original issue discounts; (9) prizes and awards; (10) medical and health care payments; (11) debt cancellations (treated as payment to debtor); and (12) cash payments over $10,000. There are different forms for different types of payments.

Employers. Give your employees their copies of Form W-2 for 2009.

For nonpayroll taxes, file Form 945 to report income tax withheld for 2009 on all nonpayroll items, such as backup withholding and withholding on pensions, annuities, and IRAs.

For Social Security, Medicare, and withheld income tax, file Form 941 for the fourth quarter of 2009.

For all taxes, deposit any undeposited tax. If the total is less than $2,500 and not a shortfall, you can pay it with the return. If you deposited the tax for the year in full and on time, you have until February 11 to file the return.

For federal unemployment tax, file Form 940 (or 940-EZ) for 2009. If your undeposited tax is $500 or less, you can either pay it with your return or deposit it. If it is more than $500, you must deposit it. However, if you already deposited the tax for the year in full and on time, you have until February 11 to file the return.

February 15

Individuals. If you claimed exemption from income tax withholding last year on the Form W-4 you gave your employer, you must file a new Form W-4 to continue your exemption for another year.

February 16

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in January if the monthly rule applies.

Begin withholding income tax from the pay of any employee who claimed exemption from withholding in 2009, but did not give you a new Form W-4 to continue the exemption for 2010.

All businesses. Give annual information statements (Forms 1099) to recipients of certain payments you made during 2009. Payments that are covered include: (1) amounts paid in broker and barter exchange transactions; (2) amounts paid in real estate transactions; and (3) payments to attorneys.

MARCH 2010

March 1

Employers. File Form W-3, along with Copy A of all the Forms W-2 you issued for 2009. If you file Forms W-2 electronically (not by magnetic media), your due date for filing them with the Social Security Administration is March 31.

March 15

Corporations. File a 2009 calendar year income tax return (Form 1120) and pay any tax due. If you want an automatic six-month extension of time to file the return, file Form 7004 and deposit what you estimate you owe.

S corporations. File a 2009 calendar year income tax return (Form 1120S) and pay any tax due. Provide each shareholder with a copy of Schedule K-1 (Form 1120S), Shareholder's Share of Income, Deductions, Credits, etc., or a substitute Schedule K-1. If you want an automatic six-month extension of time to file the return, file Form 7004 and deposit what you estimate you owe.

S corporation election. File Form 2553, Election by a Small Business Corporation, to choose to be treated as an S corporation beginning with calendar year 2010. If Form 2553 is filed late, S treatment will begin with calendar year 2011.

Electing large partnerships. Provide each partner with a copy of Schedule K-1 (Form 1065-B), Partner's Share of Income (Loss) From an Electing Large Partnership, or a substitute Schedule K-1. This due date is effective for the first March 15 following the close of the partnership's tax year. The due date of March 15 applies even if the partnership requests an extension of time to file the Form 1065-B by filing Form 7004.

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in February if the monthly rule applies.

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Citation and Resource Guide

Home Buyer's Tax Credit Is Extended, Expanded
More Gains From Business Losses

- The text of the Worker, Homeownership, and Business Assistance Act of 2009 is available at **www.govtrack.us/congress/billtext.xpd?bill=h111-3548**

  See Section 11 for details on the "Extension and Modification of First-Time Homebuyer Tax Credit."

  See Section 13 for details on the "5-Year Carryback of Operating Losses."

Good Reasons for Roth IRA Conversions

- *The Rebirth of Roth: A CPA's Ultimate Guide for Client Care* by Robert S. Keebler, CPA, MST, AEP (Distinguished), is available at **www.CPA2Biz.com** or by calling (888) 777-7077.

You Spoke — We Listened!

A number of you have told us that you prefer the former location and style of your imprinted contact information to the location and style in the new format, first implemented in the January *CPA Client Bulletin*. As a direct result of your feedback, we have changed the newsletter's design. Your February issue features your full contact information at the top of the first page, in the size and style that you've enjoyed in the past.

Subscribers who receive nonimprinted issues of the newsletter also told us that the new format left them inadequate room to stamp their firm's contact information at the top of the first page. The format of your February issue will give you ample room to customize it as you are accustomed to doing.

Implementing these design and print changes for your February issue took some time; consequently, you've likely received the issue later than you usually do. Please accept our apologies for this one-time delay.

We want the *CPA Client Bulletin* to continue to be a valuable and easy-to-use client communication tool. So we welcome your continued feedback! For technical questions about your subscription, contact customer service at (888) 777-7077 or *service@aicpa.org*. For questions about content or general feedback, contact Amy Krasnyanskaya, managing editor, at (919) 402-4060 or *CBeditor@aicpa.org*.

Thank you for your patience during this transition period and for your support of the AICPA.

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The Rebirth of Roth: A CPA's Ultimate Guide to Client Care

■ Help your clients benefit from the opportunity to convert to Roth IRAs—regardless of their MAGI or filing status—with this comprehensive guide. Written by a nationally recognized expert in retirement, estate, and family wealth preservation, *The Rebirth of Roth* brings you up to date on current rules and regulations, then digs into critical topics such as

- tax planning basics and strategies
- client and beneficiary considerations
- mathematics of IRA analysis
- the Roth Legacy Trust

An accompanying CD-ROM includes an MP3 file with further guidance from the author, as well as a valuable PowerPoint file that you can use to create your own client presentations.

[Text no. 017133—AICPA Member $89.00, Nonmember $111.25]

Timesavers—Sample Forms, Checklists, and Surveys for CPA Firm Management

■ Use the 225 interactive forms, checklists, and surveys in this handy book/CD-ROM package to streamline day-to-day operations. These forms and checklists are actual documents supplied by some of the best run firms in the country. You'll find client data information forms, client referral forms, and client interview forms. For your administrative needs, there are expense forms and scheduling forms, to name just two. For personnel documentation, you can put to work the CPA training evaluation forms, evaluation of interview forms, new employee checklists, and much, much more.

[Text no. 090484—AICPA Member $72.00, Nonmember $90.00]

2009 Individual Tax Returns Videocourse

■ Updated with even more tax planning tips, this video-based CPE course, featuring Sidney Kess and an expert panel, reviews major developments affecting 1040 return preparation for 2009 and useful tax planning strategies.

[CPE DVD Course no. 113630—AICPA Member $249.00, Nonmember $311.25]

Management of an Accounting Practice Handbook

■ Created by top CPA practitioners and recently updated, the MAP Handbook provides a vast collection of practice management guidance and tools. In three well organized loose-leaf binders, you get quick access to answer questions on a wide variety of topics, such as employee compensation and benefits, staffing, disaster recovery, firm organization, and streamlining your practice with technology.

[Text no. 090407—AICPA Member $138.00, Nonmember $172.50]

Also available as an online subscription so you can download the forms, checklists, and letters you need.

[Product no. MAPXX12—AICPA Member $150, Nonmember $250]

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