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TAX NEWS

Summer 2009 **Tax Client Newsletter**

Tax filing season is barely over but it's not too early to start looking ahead to next year, especially with the rapid pace of legislative change over the past nine months since the first economic recovery bill was passed. Another huge tax bill has become law, the American Recovery and Reinvestment Act of 2009, which expands and extends many popular tax provisions, including the child tax credit, the first-time homebuyers' credit, college credits, and bonus depreciation. But the President and Congress are not stopping there. More tax changes are being considered in Congress as part of the Obama Administration's 2010 fiscal year budget. Congress has to act on these proposals because of the need to fund government operations and because the Bush tax cuts expire at the end of 2010. A replacement plan for the Bush tax cuts is expected to pass Congress late this year. We will show you what it may look like.

Meanwhile, the IRS is struggling to keep up with the guidance taxpayers need to comply with the new rules. Some topics discussed in this newsletter include how to claim the first-time homebuyer credit and how the new withholding tables for the Making Work Pay credit could affect your 2009 tax liability. The IRS also has recognized the difficult economic times by granting relief to taxpayers who can't pay their tax bills. Details are provided below.

All of the tax changes are difficult to adjust to for both practitioners and their clients, but the news is not all bad. In fact, there are many planning opportunities you may be able to take advantage of this year, so read on.

NEW TAX BENEFITS AVAILABLE UNDER THE STIMULUS BILL

On February 17, 2009, President Obama signed into law H.R. 1, the American Recovery and Reinvestment Act of 2009, which was designed to give relief to struggling taxpayers and to stimulate certain sectors of the economy. This massive legislation extends and expands many of the tax changes enacted in the economic recovery act passed in late 2008. Below are highlights of the tax breaks contained in the new law.

TAX BREAKS FOR INDIVIDUALS

● **Making Work Pay Credit –** The refundable credit is equal to 6.2 percent of a taxpayer's earned income with a maximum credit of $800 for a married couple filing a joint return and $400 for other taxpayers, but it is phased out for higher income taxpayers. The phase-out applies for those with adjusted gross income above $75,000 for individuals and $150,000 for married couples filing jointly. The credit is available for 2009 and 2010, but may be extended under President Obama's budget proposals (See the article on the Obama budget below.) Ineligible individuals include nonresident aliens, those claimed as a dependent on another person's tax return and those who do not include a social security number on their tax return. For joint filers, only one social security number is required on the return.

The credit is being implemented through revised income tax withholding tables which employers were required to start using by April 1 of this year. Employers and payroll companies will handle this change, so taxpayers do not need to fill out new W-4 withholding forms to have the credit amount reflected in their take-home pay.

Two Important Points: Taxpayers will **not** get a separate check mailed to them from the IRS like last year's economic stimulus payment. Also, with the adjusted withholding tables, employees need to ensure that enough taxes are withheld, as the credit could reduce the withholding for a married couple with dual income by too much if the couple is ineligible or only partially eligible for the credit.

- **First $2400 of 2009 Unemployment Benefits Tax Free** -- The first $2,400 of unemployment benefits received by taxpayers in 2009 are tax free. For a married couple, the exclusion applies to each spouse separately. Unemployed workers can choose to have income tax withheld from their unemployment benefit payments. Those who choose this option will have a flat 10 percent tax withheld from their benefits. The IRS has instructed taxpayers to use Form W-4V, Voluntary Withholding Request, or the equivalent form provided by the payer, to request withholding to begin or end.

- **First-Time Homebuyer Credit – Q**ualifying taxpayers who purchase a home before December 1, 2009 receive a credit of 10% of the cost of the home purchase up to $8000 or $4,000 for married individuals filing separately. You can qualify if you have not owned a home for the past three years. Taxpayers have the option of claiming the credit either on their 2008 tax returns or on their 2009 tax returns next year. The amount of the credit begins to phase out for taxpayers whose adjusted gross income is more than $75,000, or $150,000 for married couples filing jointly. Taxpayers buying the home after December 31, 2008 do not have to repay the credit. (Taxpayers who bought a home under the previous provision during calendar year 2008 have to repay the credit over 15 years.)

Some filing options to consider are:

1) **Amend the 2008 tax return.** Taxpayers who buy a home after they filed their 2008 return can consider filing an amended tax return. The amended tax return will allow them to claim the homebuyer credit on the 2008 return without waiting until next year to claim it on their 2009 return.

2) **Claim the credit in 2009 rather than 2008**. For some taxpayers, it may make more financial sense to wait and claim the homebuyer credit next year when they file the 2009 tax return, rather than claiming it on the 2008 tax return. This could benefit taxpayers who might qualify for a higher credit on the 2009 tax return because they have less income in 2009 due to a job loss or a drop in investment income and, thus, will not be penalized by the phase-out provisions.

Instant Credit May Be Available: Buyers eligible for the credit who get FHA loans may soon also be eligible for cash advances from their loan companies up to the amount of the credit. The Federal Housing Administration has announced it will authorize lenders who do business with the agency to provide bridge loans at closing secured only by the tax credit the borrower will receive from the IRS. The bridge loans act as advances on the credit which the homebuyer can use to make the down payment or pay closing costs without waiting for the normal tax filing cycle to claim their credit.

- **Deduction for Sales and Excise Taxes on Purchase of Vehicle –** Taxpayers can deduct state and local sales and excise taxes they pay on the purchase of a new automobile in 2009. The deduction is limited to tax amounts paid on up to $49,500 of the purchase price of a qualified new car, light truck, motor home or motorcycle. Also, the deduction is allowed for purchases of motor homes or vehicles with a gross vehicle rating of not more than 8,500 pounds. The deduction is phased out for taxpayers whose adjusted gross income is between $125,000 and $135,000 for individual filers and between $250,000 and $260,000 for married couples filing jointly. To qualify, the vehicle must be purchased after February 16, 2009, and before January 1, 2010. The deduction may be taken on the 2009 tax return and is available to both those who itemize their deductions and those who take the standard deduction instead.

● **American Opportunity Tax Credit for College Costs –** The HOPE college credit has been renamed the "American Opportunity Tax Credit" and has been increased to $2500 per eligible student, beginning in 2009 or 2010. The new credit rate is 100% of the first $2,000 of qualified tuition and related expenses and 25% of the next $2,000 of qualified tuition and related expenses. The credit is available for the first four years of higher education. The credit is phased out for taxpayers with adjusted gross income between $80,000 and $90,000 ($160,000 and $180,000 for married couples filing jointly. A portion of the credit is refundable.

Note: Obama's budget proposal would make this credit permanent. Congress also is requiring the IRS to submit a study by February 17, 2010 on requiring students to perform community service as a condition of receiving tuition credits.

● **Computer Equipment Qualifies as College Expense –** Taxpayers may use funds from tax-qualified 529 accounts for purchases of computer hardware, software, internet access or related services used by a college student. The purchases must take place in 2009 or 2010. Software designed for sports, games, or hobbies does not qualify unless it is mainly educational in nature.

● **Increase in Tax-Free Transit and Vanpool Benefits –** If your employer provides transit passes and vanpool benefits to you for commuting, the amount of those benefits is excluded from your income up to $230 per month. Previously, only parking benefits were tax-free. The increase applies to months beginning on March 1, 2009 and before January 1, 2011.

● **Employee Subsidy for COBRA Coverage and Tax Credit for Employers Who Provide COBRA Benefits –** Employees who lose their jobs after August 31, 2008 and before January 1, 2010 and who elect COBRA health continuation coverage are entitled to receive a 65 percent subsidy on their COBRA premiums. For periods of COBRA coverage beginning after February 16, 2009, the employee is covered by paying only 35 percent of the premium amount. The employer may recover the other 65 percent by taking the subsidy amount as a credit on their quarterly employment tax return.

● **Child Tax Credit –** The refundable portion of the child tax credit has been increased by changing the amount refundable from 15% of earned income in excess of $12,550 to 15% of earned income in excess of $3,000, for tax years beginning in 2009 and 2010. The amount of the existing child tax credit is $1,000 per qualifying dependent child under age 17 through 2010 (and $500 thereafter). The credit is phased out for taxpayers with adjusted gross income above $110,000 for married couples filing jointly and above $75,000 for single taxpayers.

Refundable v. Nonrefundable Credits: With a refundable credit, if the amount of a credit exceeds the amount of the taxpayer's total income tax liability for the year, the excess amount is paid by the government to the taxpayer. For nonrefundable credits, you lose whatever amount of a credit that you cannot use against your tax liability.

● **Earned Income Tax Credit –** The earned income tax credit (EITC) for families with three or more qualifying children is increased to 45% for 2009 and 2010, resulting in a maximum credit of $5,656.50. The phase-out thresholds also are increased for 2009 and 2010.

● **Recovery Payment for Federal Program Beneficiaries and Retired Federal and State Employees** -- Retirees, disabled individuals, Railroad Retirement beneficiaries, and disabled veterans will receive a one-time $250 "recovery" payment in 2009. To be entitled to the payment, an individual must have been eligible for those benefit programs during November and December 2008 and January 2009. Federal and state pensioners who are not eligible for social security also will receive the $250 payment. The one-time payment will reduce any allowable Making Work Pay credit. The IRS won't be making these $250 payments. Instead, they will be made through the agency that provides the benefits under these programs.

ALTERNATIVE MINIMUM TAX RELIEF

For tax years beginning in 2009, individuals will receive some relief from the alternative minimum tax (AMT) through an increase in the exemption amounts to $46,700 for unmarried individuals, $70,950 for married couples filing a joint return and surviving spouses, and $35,475 for married persons filing separate returns. Also, nonrefundable credits are allowed against the minimum tax. Finally, tax-exempt interest on private activity bonds will not be included in the minimum tax calculation.

Minimum Tax in a Nutshell: The alternative minimum tax requires that taxpayers in the higher income brackets who have large deductions, particularly for state and local taxes and mortgage interest on loans not used for home improvements, calculate their tax twice: first, under the regular tax rules; and then under special minimum tax rules, which disallow many deductions. The minimum tax rules also include more items in income than the regular tax rules, such as tax-exempt bond interest and income from the exercise of stock options. Then, the taxpayer has to pay the regular tax amount and any minimum tax amount which exceeds the regular tax calculation. More taxpayers are subject to the minimum tax each year because it is not adjusted to reflect inflation. To ease this problem, Congress increases the minimum tax exemption amount each year, but Congress has never fixed the underlying inflation problem.

BUSINESS TAX BREAKS

The February 2009 Act created, extended, and expanded many business tax deductions and credits affecting both large and small businesses. Because some of these changes are only available this year, eligible businesses only have a few months to take action and save on their taxes. Here is a quick rundown of some of the key provisions.

● **Estimated Tax Payments** – Many individual small business taxpayers may be able to defer until the end of the year paying a larger part of their 2009 tax obligation. For 2009, business owners can make quarterly estimated tax payments equal to 90 percent of their 2009 tax or 90 percent of their 2008 tax, whichever is less. Individuals qualify if they received more than half of their gross income from their small business in 2008 and meet other requirements. To qualify, an individual must have less than $500,000 of adjusted gross income (AGI) ($250,000 if married filing separately) shown on the tax return for the preceding tax year. For purposes of this rule, a small business is one that employs no more than 500 persons.

● **Bonus Depreciation** – An additional 50% first-year write-off is allowed for business property acquired and placed in service before 2010.

● **Depreciation Cap for New Passenger Autos** -- The depreciation limit for qualified new passenger automobiles used in a business is increased by $8000 over the 2009 dollar caps. Note that the boosted depreciation limit is reduced to the extent of non-business use and does not apply if the taxpayer elects out of bonus first year depreciation.

● **Immediate Expensing Deduction**– The Act extends the higher limits on the immediate deduction for investment in business property through 2010. The limits will continue to be a total of $250,000 per year, with a limit of $800,000 for all property purchased. This limit is designed to target the expensing deduction to small businesses. The investment limit requires that the deduction be phased out dollar-for-dollar for purchase amounts in excess of $800,000. “Expensing” under the tax rules means that the business can take a higher portion of the cost of business property as a deduction in the current year instead of taking lower depreciation deductions each year over the life of the asset. Thus, businesses can expense a significant portion of the cost in the year of purchase and then take depreciation deductions over time for the rest.

● **Loss Carrybacks by Small Businesses** -- Many small businesses that had expenses exceeding their income for 2008 can choose to carry the loss back for up to five years, instead of the usual two years. For small businesses that were profitable in the past but lost money in 2008, this could mean a special tax refund. The option is available for a small business that has no more than an average of $15 million in gross receipts over a three-year period. This option is available for most eligible taxpayers for a limited time. A corporation that operates on a calendar-year basis, for example, must file a claim by September 15, 2009. For eligible individuals, the deadline is October 15, 2009.

● **Work Opportunity Credit –** Businesses may now take an expanded per-employee credit for hiring individuals in targeted groups including unemployed veterans and "disconnected youth" who are hired in 2009 or 2010. A "disconnected youth" is defined as an individual at least age 16 but not yet age 25 on the hiring date who is not attending school, is unemployed, and who is not readily employable because of a lack of skills.

● **Built-in Gains Tax** – For tax years beginning in either 2009 or 2010, the new law eliminates the corporate level tax on the built-in gains of an S-Corporation that converted from C-corporation status at least seven tax years before the current tax year.

● **Exclusion of Gain on Small Business Stock** -- To encourage investment in small businesses, the new law increases from 50 to 75% the exclusion of gain from the sale of qualified small business stock which was acquired after February 17, 2009, and before January 1, 2011 and held for more than five years. This provision is limited to individual investors and not available to corporations.

ALTERNATIVE ENERGY TAX BREAKS

Both individuals and business can take advantage of new or expanded tax benefits for costs associated with reducing energy use or creating new energy sources. Two of the more useful credits for individuals are the new tax credit for plug-in electric vehicles and the credit for making energy efficient improvements to your home. Here's a run down of some of the new provisions.

● **Residential Energy Property Credit --** Taxpayers can now get a generous credit for making energy efficient improvements to their existing homes equal to 30 percent of the cost up to $1,500 for 2009 and 2010.The credit applies to improvements such as adding insulation, energy efficient exterior windows and energy-efficient heating and air conditioning systems.

Note: For information on efficiency standards and what type of equipment qualifies for the credit, you can go to the government's information website at http://www.energystar.gov. Most manufacturers and installers also have information on which models qualify for the credit.

● **Residential Energy Efficient Property Credit** -- This nonrefundable energy tax credit will help individual taxpayers pay for qualified residential alternative energy equipment, such as solar hot water heaters, geothermal heat pumps and wind turbines.

● **Plug-In Vehicles** – Taxpayers may take a new 10%, nonrefundable credit for vehicles bought after February 17, 2009 and before January 1, 2012, including electric drive low-speed vehicles, motorcycles, and threewheeled vehicles. The maximum credit amount is $2,500. A new 10% credit also is allowed for the cost of converting any motor vehicle into a plug-in vehicle, with a maximum credit of $4000.

● **Business Credits for Manufacturing Green Equipment and Producing Alternative Energy –** Manufacturers get a new credit for producing clean energy equipment. Businesses that produce electricity from alternative sources also can get a generous credit or apply for a grant to offset their costs.

IRS REACHING OUT TO HARD-HIT SMALL BUSINESSES WITH SPECIAL RELIEF MEASURES

The IRS has put in place special programs to help small business owners -- primarily Schedule C filers - - facing hardship as a result of the economic downturn. Here's a list of IRS initiatives aimed at helping small business:

- **Offering Installment Agreements:** The IRS has instructed its agents who are examining returns to consider collectability during the pre-audit phase. They also are being encouraged to offer installment agreements at the end of an audit when taxpayers are having difficulty paying all of the tax at once, thereby enabling them to minimize interest and penalty charges.

- **Postponement of Collection Actions:** IRS employees may suspend collection actions in certain hardship cases where taxpayers are unable to pay. This includes instances when the taxpayer has recently lost a job, is relying solely on Social Security or other assistance or is facing devastating illness or significant medical bills.

- **Added Flexibility for Missed Payments:** The IRS has flexibility in working with taxpayers who have previously complied with a payment schedule who are now having difficulty making payments because of financial hardship. The IRS may allow a skipped payment or a reduced monthly payment without automatically suspending the Installment Agreement.

- **Prevention of Offer in Compromise (OIC) Defaults:** Taxpayers who are unable to meet the payment terms of an accepted offer in compromise will receive a letter from the IRS outlining options available to help them avoid default.

- **Expedited Levy Releases:** The IRS will speed the delivery of levy releases by easing requirements on taxpayers who request expedited levy releases for hardship reasons.

- **Fast Track Settlement**: The IRS is using its Fast Track Settlement (FTS) program to settle cases more quickly than is possible with its traditional Appeals procedures. This process is especially beneficial to taxpayers who have a tax liability in dispute that is greater than $25,000. It speeds up the process and gets the IRS Appeals office involved at an earlier stage.

- **Lien Assistance –** The IRS has changed its procedures to better assist taxpayers with lien releases. When a taxpayer cannot pay the full amount on a lien and there is a pending real estate transaction or refinancing, the IRS provides them with information about partially discharging liens, subordinating them to other lenders' liens, and the telephone number to call to inquire about lien assistance.

EMPLOYER RELIEF TO SAVE 401(K) PLANS

To prevent cash-strapped employers from terminating their employees' 401(k) plans, the IRS is allowing some employers to reduce or suspend certain required contributions they make to their employees' individual plan accounts as long as the employers follow certain notice and timing procedures.

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TAX PROPOSALS IN OBAMA'S BUDGET CURRENTLY BEFORE CONGRESS

President Obama unveiled his budget proposal on February 26, 2010. The budget blueprint raises revenue by approximately $1 trillion over 10 years but contains an additional $1 trillion in spending cuts over the same period. Many of the tax provisions would not take effect until 2011.

The tax increases are said to fall mostly on high-income individuals. The revenue raised is supposed to fund health care reform, according to the budget description. One of the most controversial proposals is the plan to limit the value of itemized deductions to 28% for upper income taxpayers. Interestingly, much of the opposition is coming from the President's own party, including Congressional leaders who are concerned about the effect on charities and on the housing market, since charitable deductions and home mortgage interest deductions would be capped at 28%. Legislation containing these proposals is moving through Congress and is expected to be passed in Fall 2009. Set forth below is a list of possible changes that could affect your tax bill in the near future.

UPPER INCOME TAX INCREASES:

-- Increase the top rates for taxpayers earning over $250,000 (married taxpayers) or $200,000 (for singles) to 36 and 39.6 percent.

-- Reinstate the personal exemption phase-out and itemized deduction limitation for taxpayers earning over $250,000 (married taxpayers) or $200,000 (for singles) which is set to expire in 2010.

-- Increase the capital gains and dividends tax rate from 15% to 20% for taxpayers earning over $250,000 (married taxpayers) or $200,000 (for singles).

INDIVIDUAL TAX CUTS:

-- Make permanent the following credits:

- Making Work Pay Credit
- Child Tax Credit
- New American Opportunity Tax Credit (for college expenses)

-- Expand the Earned Income Tax Credit

-- Expand saver's credit and provide automatic enrollment in IRAs and 401(k)s.

BUSINESS TAX CUTS:

-- Completely eliminate capital gains tax on small businesses.

-- Make permanent the research and experimentation credit.

-- Extend the carryback period for business losses to five years.

OTHER TAX CHANGES:

-- Freeze the estate tax at its 2009 level which includes an exemption for estates valued at up to $3.5 million and a top rate of 45 percent.

-- Require information reporting for rental payments.

-- Tax carried interest paid to managing partners as ordinary income instead of capital gains.

ALTERNATIVES TO TRADITIONAL HEALTH INSURANCE TAX BENEFITS BEING CONSIDERED IN CONGRESS

A new bill, the Small Business Health Options Program (SHOP) Act of 2009, would create a national small-business health insurance purchasing pool and give tax credits for the health insurance expenses of small businesses. The bill has bipartisan support in Congress and also is backed by some key business and labor groups. Under the program, small businesses would receive a tax credit of up to $1000 per employee if the business covers at least 60 percent of employee premiums. Employers funding more than 60 percent of premiums would receive a bonus tax credit. Self-employed workers would be eligible for a $1,800 tax credit ($3,600 for families).

As an alternative, Republicans have introduced the Patients' Choice Act of 2009, which is designed to increase private coverage of the uninsured. Sponsored by key Republicans, the bill would replace the current tax exclusion for employer-provided healthcare plans with a refundable $2,300 tax credit ($5,700 for families) for employees to allow them to purchase their insurance. The credit could be received in advance for taxpayers unable to afford the premiums. The bill also would allow taxpayers to use health savings accounts to pay for health insurance premiums.

Some type of health care reform bill is expected to be voted on in late Summer. Both businesses and individual taxpayers could be affected. In fact, health care reform could bring unprecedented change to the current system of tax-free health insurance benefits provided by employers. Keep your eye on this one.

VICTIMS OF PONZI SCHEMES MAY TAKE DEDUCTION FOR THEFT LOSSES, IRS RULES

The IRS has issued guidance to taxpayers on how to deduct losses from fraudulent investment arrangements, such as Ponzi schemes. If there was criminal intent to defraud the investor, then the loss is considered a theft loss under the tax law, not a capital loss. Theft loss deductions can be taken in the year the taxpayer discovers the loss. However, if there is a reasonable chance of recovering the money, the loss deduction cannot be taken until the tax year in which the taxpayer can tell whether or not he will receive the reimbursement. The amount of the deduction is the amount invested in the arrangement, less amounts withdrawn, reduced by reimbursements or other recoveries.

The IRS also has provided a so-called “safe harbor” formula under which defrauded investors can claim a theft loss deduction the IRS will not challenge. The calculation is complex and must be reported on a specific IRS form. The taxpayer also must sign a statement containing specific information about the investor and the fraud and attach it to the return. Thus, this type of claim is best left to your tax preparer. Also, the investor may have income or an additional deduction in a later year depending on the actual amount of the loss that is eventually recovered. The safe harbor procedure only applies to losses discovered beginning in 2008.

IRS SEEKS TO BRING OFFSHORE TAX EVADERS INTO THE FOLD

In a major new initiative, the IRS has unveiled new incentives for people with offshore accounts to turn themselves in voluntarily over the next six months, pay what they owe and answer questions about who helped them set up secret accounts. Government officials are offering milder penalties than could otherwise be imposed -- and a reduced likelihood of criminal prosecution.

TAXPAYERS IN SOME STATES ELIGIBLE FOR DISASTER RELIEF

In the last several months, the IRS has declared taxpayers in a number of states eligible for disaster relief in the form of later filing deadlines and penalty waivers on tax deposits. States on the list include Arkansas, Indiana, Georgia, Florida, Minnesota, and North Dakota. We can assist you to obtain relief, if you receive a penalty notice or otherwise need to qualify.

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IT MAY NOT BE TOO LATE FOR INNOCENT SPOUSES

The U.S. Tax Court slapped the IRS on the wrist this month by holding one of its innocent spouse regulations invalid. Congress enacted a special equitable relief provision for innocent spouses who could not take advantage of the standard rules because of some legal technicality. The IRS tried to impose the two-year limit of the regular innocent spouse rules to the equitable relief provisions, but the Tax Court would have none of it. The Tax Court struck down the two-year limit, commenting that the nature of equitable relief is to address hardship cases, such as missed deadlines, unforeseen circumstances, etc. You should see us, if you think you qualify for such equitable relief.

DIRTY DOZEN TAX SCAMS FOR 2009

The IRS has issued its 2009 "dirty dozen" list of tax scams. "Taxpayers should be wary of scams to avoid paying taxes that seem too good to be true, especially during these challenging economic times," IRS Commissioner Doug Shulman commenting when releasing the list. Here’s some of the 2009 list:

Phishing

Phishing is a tactic used by Internet-based scam artists to trick unsuspecting victims into revealing personal or financial information. These scams send e-mails which appear to come from the IRS promising a refund. If the taxpayer sends personal or financial information back, this information is used to steal the person’s identity or raid their bank account.

Hiding Income Offshore

Taxpayers try to avoid or evade U.S. income tax by hiding income in offshore banks, brokerage accounts or through other entities. Taxpayers also evade taxes by using offshore debit cards, credit cards, wire transfers, foreign trusts, employee-leasing schemes, private annuities or life insurance plans.

Filing False or Misleading Forms

Some scam artists file false or misleading returns to claim refunds that they are not entitled to, such as Form 1099-Original Issue Discount (OID), claiming false withholding credits.

Abuse of Charitable Organizations and Deductions

Exempt organization scams include arrangements to improperly shield income or assets from taxation and attempts by donors to maintain control over donated assets or income from donated property. Another area of abuse is the donation of over-valued assets.

Return Preparer Fraud

Dishonest return preparers can cause many headaches for taxpayers who fall victim to their ploys. These preparers skim a portion of their clients' refunds and charge inflated fees for return preparation services. They attract new clients by promising large refunds.

Frivolous Arguments

Promoters of frivolous schemes encourage people to make unreasonable and unfounded claims to avoid paying the taxes they owe. The IRS has a list of frivolous legal positions that taxpayers should avoid. Taxpayers who file a tax return or make a submission based on one of the identified abuses on the list are subject to a $5,000 penalty.

Abusive Retirement Plans

The IRS continues to find abuses in retirement plans, including Roth Individual Retirement Arrangements (IRAs). The IRS is looking for transactions that taxpayers are using to avoid the limitations on contributions to IRAs as well as transactions that are not reported as early distributions. The IRS warns taxpayers to be wary of advisors who encourage them to shift appreciated assets into IRAs at less than fair market value to circumvent annual contribution limits.

Disguised Corporate Ownership

Some taxpayers form corporations and other entities for the primary purpose of disguising the ownership of a business or financial activity. Such entities can be used to facilitate underreporting of income, fictitious deductions, non-filing of tax returns, participating in tax shelters, money laundering, and financial crimes.

Misuse of Trusts

The IRS notes that, for years, unscrupulous promoters have urged taxpayers to transfer assets into trusts. Some promoted transactions promise reduction of income subject to tax, deductions for personal expenses and reduced estate or gift taxes. Such trusts rarely deliver the promised tax benefits and are being used primarily as a means to avoid income tax liability and hide assets from creditors, including the IRS.

Fuel Tax Credit Scams

The IRS is receiving claims for the fuel tax credit that are unreasonable. Some taxpayers, such as farmers who use fuel for off-highway business purposes, may be eligible for the fuel tax credit. Some individuals are claiming the tax credit for non-business uses of fuel.

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STATES LOOK TO NOVEL WAYS TO RAISE REVENUE

If you are excited about getting a few more dollars in your paychecks thanks to the new stimulus bill, your federal tax break may be offset by new State taxes. Many states are considering major increases in sales and income taxes to backfill some of the shortfall they are experiencing in their tax revenues from the dramatic downturn in the economy. Unlike the federal government, many states cannot run a deficit under state law but instead must balance their budgets by raising taxes, cutting spending or dipping into their reserves, if they have any.

To give you a feel for the new frontier of state taxation, we have assembled information on several recent state tax initiatives, described below.

- **Connecticut** is faced with trying to raise $3 billion extra from sales tax in the next two years.

- **Delaware** Gov. Jack Markell wants to raise the marginal income tax rate by one percentage point, to 6.95%.

- **New York** and **Washington State** have discussed a tax on pornography.
- **Oregon** is looking at a Beer Tax increase of 1900%.
- One **California** legislator has introduced a weed tax which would legalize and tax marijuana, which could bring in as much as $1 billion.
- Some officials in **Nevada** have proposed legalizing prostitution throughout the state, not just in a few areas as it is now, to raise $200 million in taxes.
- Lawmakers in **New Jersey** are considering taking food taxes a step further and placing a "sin" tax on fast food. The U.S. Congress briefly considered a tax on sugary sodas this year, but the idea was put aside.

THANKS FOR YOUR BUSINESS

As your tax professional, I assure you that I will be keeping a watchful eye on Congress and on IRS actions which may affect your tax filings. I will be happy to address any concerns and answer questions you have about your taxes and the issues covered in this newsletter.

Thank you for reviewing the Summer 2009 Tax Client Newsletter and for the opportunity and privilege of allowing me to serve as your tax professional. Rest easy. Good things happen in the Summer. For one thing, Congress usually leaves town.

Best regards,
Lloyd Hudson