

CLIENT REPORT:

2009 Third Quarter Federal Tax Developments

Dear Client:

The third quarter of 2009 has seen a flood of new federal tax developments. We'd like to highlight some of the more important federal tax developments for you. As always, please give our office a call or send us an email if you have any questions about these developments.

Health care reform. Congress returned to work after its August recess with health care reform at the top of its agenda. The tax provisions in the pending bills are very different from each other and it is unclear at this time which will be enacted. The House has proposed a surtax on higher-income individuals to pay for health care reform. This approach has little support in the Senate. A final Senate bill is likely to include new taxes on high-dollar health insurance plans. President Barack Obama wants Congress to get a health care reform bill to the White House before 2010. Our office will keep you posted of developments.

Audits. The IRS is gearing up to launch a new employment tax compliance project. The project is expected to focus on four areas: worker classification, fringe benefits, non-filers, and officers' compensation. Taxpayers will be randomly selected for the National Research Program (NRP) study of employment tax noncompliance.

Penalties. The IRS announced a temporary freeze on the collection of Code Sec. 6707A penalties in July and extended the moratorium in September. Many small businesses have complained that the penalties are out of proportion to any tax benefits received. In some cases, small business owners purchased benefit plans that turned out to be tax shelters. The IRS will suspend collection through December 31, 2009 in cases where the annual tax benefit from the transaction is less than the penalty imposed under Code Sec. 6707A(b)(2): \$100,000 for individuals or \$200,000 for other taxpayers, per year. The suspension is intended to give Congress time to pass corrective legislation.

Levies. In July, IRS Chief Counsel determined that the agency can levy on a taxpayer's health savings account (HSA). The taxpayer would also be liable for an additional tax because an IRS levy on an HSA is not a distribution to pay qualified medical expenses.

First-time homebuyer credit. The first-time homebuyer credit, which reaches 10 percent or \$8,000 of the purchase price of a qualified residence, is set to end after November 30, 2009. A residence constructed by the taxpayer only qualifies for the first-time homebuyer credit if the taxpayer must occupy the residence on or before November 30, 2009.

Motor vehicle sales tax deduction. In July, the IRS reminded taxpayers that the motor vehicle sales tax deduction may be claimed for more than one vehicle but the deduction per vehicle is limited to the tax on up to \$49,500 of the purchase price of each qualifying vehicle. The deduction phases out for higher-income individuals. If you are considering a new car or truck purchase before year-end, please contact our office for more information about this valuable tax incentive.

Compensation. In July, the IRS determined that discounted stock options do not qualify as performance-based compensation. Compensation paid on the exercise of discounted stock options will be subject to the \$1 million deduction limit in Code Sec. 162(m) for public companies and will not qualify for the exception for performance-based compensation.

Filing status. The Tax Court signaled in July that it does not plan to extend married filing joint status to same-sex couples anytime soon (*Merrill v Commr*). Married filing joint status is based on a marriage, the court found. The Defense of Marriage Act of 1996 declared for federal purposes that marriage is between a man and a woman and a spouse is defined as a person of the opposite sex.

Voluntary disclosure. Earlier this year, the IRS announced a temporary initiative to encourage taxpayers with undisclosed foreign bank accounts to come forward. The offshore disclosure program was originally scheduled to end on September 23, 2009. The IRS extended the deadline to October 15, 2009. Taxpayers must pay back taxes plus interest and penalties for six years and the IRS will waive the 75 percent fraud penalty. The IRS has indicated it will not seek criminal prosecution.

FBAR. The IRS also extended temporary relief for certain filers of Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR), to October 15, 2009. Eligible taxpayers are taxpayers who recently learned that they had FBAR filing obligations for years prior to 2009 and taxpayers who recently learned that they have a current FBAR filing requirement for 2009 but did not have sufficient time to properly file by the June 30 due date. Taxpayers with signature authority over foreign accounts and taxpayers with foreign hedge funds or private equity accounts have an extended due date of June 30, 2010.

Foreign bank accounts. In August, the U.S. and Switzerland resolved their dispute over disclosing the names of Americans with accounts at Swiss banking giant UBS AG. Information from as many as 4,500 UBS accounts may ultimately be disclosed to the IRS.

Roth IRAs. Effective for 2010, individuals will be able to roll over funds to a Roth IRA regardless of current income and other restrictions, the IRS reminded taxpayers in September. The IRS also issued interim guidance on rollovers from employer plans to Roth IRAs. It's not too early to start planning for Roth IRA conversions. Please contact our office if you have any questions.

Retirement savings. President Obama and the IRS announced new initiatives in September to encourage Americans to save for retirement. The IRS issued seven rulings and notices to streamline automatic enrollment in retirement plans and more.

Refunds. Starting in 2010, taxpayers can check a box on their return to use all or part of their refund to purchase Series I U.S. savings bonds. The bonds will be mailed directly to the taxpayer.

Privilege. The IRS won an important victory when the First Circuit Court of Appeals ruled in August that tax accrual workpapers were not protected from disclosure under the work product doctrine (*Textron v US*). The court agreed with the IRS that the taxpayer had waived any applicable privilege by disclosing the workpapers to an independent auditor.

Listed transactions. The IRS updated its roster of listed transactions in July. These are transactions the IRS has identified as abusive and that are subject to special disclosure and registration rules. The IRS also updated its list of transactions of interest. These are transactions the IRS is monitoring for abuses.

COI income. The IRS issued election procedures in August for deferring cancellation of indebtedness (COI) income on repurchased debt. The American Recovery and Reinvestment Act of 2009 enacted Code Sec. 108(i) giving taxpayers an election to defer COI income from the reacquisition at a discount of an applicable debt instrument in 2009 or 2010. The income is deferred until 2014 and then must be reported ratably over five years, through 2018.

WOTC. The American Recovery and Reinvestment Act of 2009 added two new targeted groups for the Work Opportunity Tax Credit (WOTC): disconnected youth and unemployed veterans working for

an eligible employer during 2009 or 2010. In August, the IRS clarified who qualifies as a disconnected youth or unemployed veteran and provided some transition relief.

S corporations. S corporations are a popular choice of business entity. The IRS reminded S corporation shareholders that when corporate officers perform a service for the corporation and receive, or are entitled to receive, payments, these payments are considered wages.

Accounting methods. In September, the IRS announced revised procedures for automatic consent to change of accounting method. Generally, taxpayers must obtain IRS consent to change a method of accounting. The IRS has attempted to streamline this process by permitting taxpayers to obtain automatic consent for over 140 enumerated changes.

LLCs and LLPs. In July, the Tax Court rejected the IRS's claim that members of limited liability companies (LLCs) and limited liability partnerships (LLPs) should be automatically presumed not to materially participate in the entities' activities under the Tax Code or temporary regulations (*Garnett v Commr*).

These are just highlights of some of the important federal tax developments during the third quarter of 2009. Please contact our office for more details.

Sincerely yours,

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