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TAX NEWS & TIPS

MID-YEAR 2009

Whew! It's Over!

Tax season was extra tough this year. The turmoil in the economy threw us all some curves. I fear there is more in store.

First, I certainly owe you a big THANK YOU! Thanks for the good order of your records. Thanks for being patient at my busiest time. Especially – Thanks for the trust and confidence you placed in me. I'll keep working to earn this from you.

Whoops! New Laws!

Wow! In the past two years we have seen 14 new tax laws. The last time Congress produced such bulk was in 1986 and 1987. And, there's more to come. Just check the news – bailouts, recession, unemployment. We can bank on more new laws.

My head is spinning! Tax time was tough. Now I need to grapple with dozens of new rules for 2009. I'll try to explain some changes that impact lots of people. I'm still trying to understand all of the new laws.

NEW For Nearly Everyone.

One or more of three new programs will affect most folks:

1. Making Work Pay Credit.

This one gives a \$400 tax cut to most working people. (Working couples get \$800.) For last year's "rebate" IRS sent checks. This one will be handled by reduced withholding at work. Most employers started using new withholding tables on April 1.

2. Social Security Recipients

got a "one-time" \$250 payment in May or June. The extra payment went to anyone collecting social security, SSI, railroad retirement, veteran's disability or pensions.

3. \$250 Credit To Retired Government Workers will be claimed on the 2009 tax return.

OOPS These are Related! It is assumed social security recipients and government retirees don't work. If they do work, the Making Work Pay credit is reduced. Oops! If you collect the credit as reduced withholding at work, you might owe tax when you file your 2009 return!

For most, the credits are nearly automatic. The result will inject over \$200 billion into the economy. But, some of you may get a rude surprise when you file in 2010.

Limitations. The payments for social security and the government retiree credits are "one-time" items. The Making Work Pay Credit runs for 2009 and 2010, but has limits. It's 6.2% of "earned" income, with a cap of \$400. It takes \$6,451 of W-2 (or self-employment) for the \$400 maximum. There's an income limit, too. As total income passes \$75,000, the credit phases out. It disappears at \$95,000. The limits for a couple are the double of this. Anyone who is claimed as another's dependent may not claim the credit.

Problem Cases. If your withholding at work declined on April 1, you may owe taxes next year if you:

- you work more than one job,
- you also collect social security or a government pension,
- you and spouse both work, or
- you collect a significant bonus.

Withholding declined for pensions, too, but there is no credit – whoops!

Apply to you? Call me. I can help decide if you owe taxes.

NEW Sales Tax on New Cars.

Buy a new car on or after February 17, 2009 and deduct the sales taxes. Only 2009 purchases count. There are limits – only the first \$49,500 of cost counts, and the deduction phases out as your income ranges from \$125,000 to \$135,000 (\$250K to \$260K for a couple). You

get the deduction even if you can't itemize deductions, and you can't lose it to the Alternative Minimum Tax. Not yet clear: Can each spouse buy a car? Can you claim this on two cars to a total of \$49,500? We hope IRS issues guidance on these issues before it's too late to help.

NEW Lost Your Job? When you collect unemployment you are taxed on the income. For 2009 only, each person escapes tax on the first \$2,400 of unemployment insurance collected.

NEW Homebuyer Credit. Last year we got a "credit" for "first-time" homebuyers. "First-Time" means you did not own a home in the prior three years. You get 10% of the home's price with a \$7,500 "cap". It's really a loan, paid back over 15 years, interest-free. It was for purchases between April 6, 2008 and July 1, 2009. Now it's sweeter. The new credit affects any 2009 purchase before December 1. A higher \$8,000 applies. Best of all, there's no repayment unless it ceases to be your main home within 3 years. There's still a phase out – credit phases out over a \$20,000 range as

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income reaches \$75,000 (\$150,000 for couples). There is an election to treat any qualified home as if it were bought December 31, 2008. This gets the money to you earlier.

NEW Energy Credits Return.

The popular energy credits in '06 and '07 helped with common home improvements. They are back: insulation, exterior doors, windows, skylights, insulated roofing material, non-electric furnaces and water heaters. The old 10% credit triples to 30%. The lifetime limit of \$500 in credits is repealed. Now it's a \$1,500 limit for 2009 and 2010. Certain central air conditioners work, but check with the builder or retailer to be sure your device meets complex standards for the credits. Bigger credits for solar, wind, and geothermal units are here, too, but few can afford them.

NEW Education Credits Are Juicier.

The Hope Credit reduced costs of the first two years of college. For 2009 and 2010 the credit is renamed as the "American Opportunity Tax Credit" and made more liberal. Maximum increases from \$1,800 to \$2,500, and it now covers 4 years of post-secondary education leading to a certificate or degree. The old credit only counted tuition and fees – now it includes books and course materials. The

\$2,500 is 100% of the first \$2,000, plus 25% of the next \$2,000. More folks will collect – income phase out starts at \$80,000 (was \$50,000), and at \$160,000 for couples. Better yet, you get the credit even if you pay Alternative Minimum Tax. A bonus for those with low taxes – up to 40% of the credit can be claimed even if you pay no income tax!

NEW And Lots More! There are many more changes in the most recent laws. I have time and space for only a brief mention:

Section 529 Plans are used to save for a college education. Growth is tax-free if spent on costs of the education. The new law adds buying a computer as a qualified cost, as long as the student uses it.

Child Tax Credit of \$1,000 for each child under age 17 can be lost if your tax bill is low. New law makes it easier to recover a lost credit.

Earned Income Credit offers refunds to workers families with children. There are 2 levels of credit – one if there is a single child, and more if there are 2 or more children. New law adds a 3rd level for those with 3 or more children. Also, the credit phases out as income rises – the income limit is higher for 2009 and 2010.

AMT Patch. "AMT" stands for the Alternative Minimum Tax. It

was designed to make wealthier folks pay their "fair share" of taxes, but has begun to affect ordinary citizens. New law gives another one-year "patch" to keep the tax from affecting nearly 23 million returns. It also protects several "personal" tax credits from being erased by the AMT.

Depreciation Issues. Two provisions were extended to 2009.

1) Businesses may elect to expense up to \$250,000 of equipment that is normally depreciated. 2) "Bonus" depreciation, which allows writeoff for 50% of the cost of an asset, then depreciation for the balance.

Business Losses can generate a "net operating loss" which can be used to recover taxes paid up to three years in the past. New law allows carrying such losses back to the 4th or 5th prior year.

Investment Losses. Normally, investment losses are not treated as favorably as business losses. A new ruling gives business treatment to certain Ponzi scheme losses, as long as the perpetrators are under criminal indictment.

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This publication has been sent to you by your tax advisor for informational purposes only. The opinions are generalizations and may not apply to all taxpayers.

After Your Tax Return Is Filed - - -

All Done? Not quite. Some returns were extended; some of you still owe money; a few refund checks go astray. And - - - when we're done, IRS begins it's work.

Loose Ends? Some didn't complete the 2008 tax cycle:

Extended Return? Returns are due by October 15. Payment was due April 15, and carrying charges apply after this. Gather the missing paperwork quickly – a last-minute surprise can be expensive!

Refund Late? IRS won't help until 10 weeks after you file. 1-800-829-4477 is for automated help. Or try 1-800-829-1954 – the refund hotline. The IRS website www.irs.gov has a "Where's My Refund?" link.

Find an Error? If you failed to claim an item on your return, we can file an amended return. You and IRS each have the same time frame to question your return. It's 3 years after the filing deadline. If you owe IRS you pay the tax plus some interest. If IRS owes you, the same thing applies – you collect the tax savings plus interest.

Keep Your Return and Records. For now, put your return, records, receipts, and cancelled checks in a safe place. You should keep the returns indefinitely; the records should be kept for 5 years. You might need to dig them out, but chances are slim.

Will You Be Audited? Not likely. What does IRS do after you file? Soon they will match reports from banks, brokers, and employers with tax returns. Most "audits" arise when IRS finds a mismatch. They send a letter - - -

Uh-Oh – an IRS Letter! If you get a letter from IRS, call me. The letter may be confusing. There are several types of notices and each requires a different response. Don't risk making an even bigger mess – I'll be glad to handle it.

When IRS questions anything on your return they call this an "audit". Most people picture an "audit" as a face-to-face meeting with an IRS employee who asks lots of questions. IRS has just released statistics for the fiscal year ending in September 2008. They received about 138 million returns, and "audited" 1.39 million of these. That's only 1% of the total. Of these, less than 23% involved meeting with IRS – the rest were handled by correspondence.

The correspondence "audit" usually arises from the IRS "matching" program. It involves copying your records and verifying the return. Face-to-face audits are more complex. We'll need to meet and discuss the issues. But, please remember, only about 1-in-400 of all returns are subjected to this sort of scrutiny.

Tax Topics For Tough Times

Stock market down. Double-digit unemployment. Business closures. Corporate bailouts. Most of us are feeling the effects of a tight economy in one way or another.

I certainly hope things are going well for you. But, if you're feeling the pinch, I want to pass along some ideas that can save precious dollars at tax time.

✓ Lost Your Job? I know you're busy looking for alternatives, but you can save taxes by paying attention to:

Unemployment. Don't forget – the first \$2,400 of unemployment benefits in 2009 is tax-free. The rest is taxable. I can help figure whether this will cause a problem when you file your 2009 return. Call me.

Job Search costs are deductible. Mileage, telephone, fees to agencies, costs for a resume, or to collect employment files.

Job Training. Most vocational schools are "qualifying educational institutions". This opens the door for valuable tax benefits. Be sure to ask *before* you sign up.

Moving Expense. If you are forced to re-locate, there are valuable deductions for moving to the new job site. Keep track of all costs.

"Consultant" vs. Employee. If you are considering working as a "consultant", we need to talk. Tax law will say you are "self-employed". There's a world of difference in how you claim your deductions, and in how you pay taxes.

✓ Credit Woes? If you manage to negotiate a reduction in credit card or other consumer debt, call me right away. Any cancelled debt balance is *income* to you! The fancy name is "cancellation of debt" income – but, it's definitely taxable. Call me.

✓ Home Foreclosed? The issue is cancelled debt again. Suppose you owe \$200,000 on a home, and cannot keep up the payments. If the bank forecloses, and sells the property for, say, \$160,000, you probably will see the \$40,000 shortfall reported as income. It may be possible to use tax laws to exclude this income. Rules are complex, and I need information on the debt and any refinancing you did. Some loans get re-negotiated. Similar rules apply. This is a very tricky area of tax law.

✓ Portfolio Down? If you are looking at a statement showing your holdings have declined, this is simply a "paper" loss. No tax relief applies until you "realize" the loss by selling the assets. And that's a very tricky *investment* decision. I need to warn you of a limit of \$3,000 in overall losses you may claim in any one year. If you decide to sell a significant part of your holdings, please call me. The *investment* decision is yours, but I can help by clarifying the *income tax* effects of your decision.

Similar rules apply to a pension fund. The value may be down, but there is no immediate tax relief.

✓ Pension Withdrawals? If you turn to your pension or IRA to help you to "ride out the storm", please call me first. There are serious tax issues if you touch any "retirement-like" funds before age 59½. Both an income tax and a penalty may apply. There are some ways to remove the penalty, but simple "hardship" is rarely a good enough reason. You need to know the cost of what you might choose to do *before* you decide. Borrowing may prove to be a cheaper choice than tampering with pension money. You must make your own decisions. My job is to help you make *informed* choices.

Who Pays The Most Tax?

We've all heard "the rich hardly pay any tax". Is this true? Nope! IRS statistics for 2006 income tax returns might surprise you.

The wealthiest definitely pay the most tax. But, your guess of what is considered "wealthy" may be a shock, too.

Be careful! The chart below needs some thought. The Census Bureau counts *people* – IRS counts *tax returns*. We have 304 million Americans, but only 138 million tax returns. A family might file a single return. Those with very low income are not required to file at all. Few returns come from Americans under age 18.

Imagine that all tax returns are stacked in a huge pile in order of their reported income, with highest incomes on top, and lowest incomes on the bottom. Looking closely at this giant stack - - -

	All Tax Returns	Top 1%	Top 5%	Top 10%	Top 50%
Number of Returns (millions)	138	1.38	6.92	13.8	69.2
AGI (Dollars)	N/A	\$388,806	\$153,542	\$108,904	\$31,987
Share of Income (percent)	100.0	22.1	36.7	47.3	87.5
Tax share (percent)	100.0	39.9	60.1	70.8	97.0

Number of Returns. This row counts only returns with positive income. It is possible to have a return with negative income.

AGI refers to Adjusted Gross Income. It's the bottom number on Page 1 of Form 1040. Not all "income" is included. Tax-exempt interest is not. Social Security income may be absent, or *part* may be included. A business or rental can have negative income.

Tax Share is surprising. The top 1% of returns generate nearly 40% of all income tax revenue, but had only 22% of all reported income. Also note – the top 50% of returns pay 96.7% of all income tax. The lower 50% of returns pay only 3.0% of all income tax, or about \$26 billion. In truth, the lower 50% *collect* more than they *pay*, because of the earned income credit, but this credit comes from Social Security taxes, not income tax!

Surprised? Many couples with an income just over \$100,000 probably consider themselves to be "middle income". IRS would definitely call them "wealthy" and place most of them in the top 10% of all incomes.

Tips For You

Owe IRS? Some Suggestions.

When you owe the IRS, they put big pressure on you to pay immediately or to set up a payment plan. Watch out! The fee to set up a plan is \$105! If you can pay your balance in three months or less, send what you can now, wait for the next bill, send more, then pay the balance with the third billing. Save the \$105.

If you will need more time, ask for a payment plan. If you agree to have payment debited directly from a checking account, the cost to set up the plan drops to \$52.

IRS charges interest, plus a "late payment" penalty on all balances. Interest is currently 5%. The penalty for paying late adds 6%, but is often cut in half for payment plans.

Unemployed? New Health Care Subsidies. An employer of over 20 employees must offer health care continuation coverage (COBRA) to involuntarily terminated employees for up to 18 months. Employee pays the premium, plus administrative fee. The coverage may still be more than many employees can afford. New law gives employees up to 9 months of coverage by paying only 35% of the premium, with 65% paid by the government. There are many other rules, but if this might affect you, please contact former employer.

An even more generous program, the Health Care Tax Credit (HCTC)

began in April – those eligible for HCTC might pay as little 20% of the full premium. Coverage can extend through 2010 if needed. Check the IRS website for full details.

Over 70½? Required Distributions Waived. At age 70½ folks must take annual distributions from IRA and retirement funds. For 2009, the requirement is waived. Do what you wish. Need the money? Take it. If you don't need the money, you might have a planning opportunity. You may be able to take just enough to avoid changing tax brackets. Late in the year is the best time for such decisions – we need to know your income for the year.

Charged Your Tax? IRS accepts tax payments via credit card. I rarely recommend this because of fees you must pay the credit card company – usually about 2.5% of the payment. IRS has had a change of heart, and now says you may deduct this fee on your next return! A little hitch – you must itemize deductions, and this fee is a "Miscellaneous" deduction – no benefit unless these deductions exceed 2% of your gross income.

Tax-Free Vacation Money. Going on a summer vacation? You can rent out your own home for up to 14 days while away. Stick to this time frame, and it's legal to pocket the money – no taxes. Local papers have listings for such rentals. You can likely pay for a good bit of your own vacation. And – it's legal!

Over 70½ – IRA To Charity. 2009 is the last year of a tax break for older folks who give to charity. For your charitable contributions, do this: have your IRA *custodian* send a contribution *directly* to the charity from your IRA. You only pay tax on any additional distribution you take. You don't even need to itemize your deductions – the amount sent to the charity is not treated as income. You might have a "double win" here – the reduction in your income may cause less of your social security income to be taxable. Neat.

I don't make jokes. I just watch the government and report the facts.

Will Rogers

Your Tax Calendar

June 15	2 nd quarter estimated tax payments due.
July 31	2 nd quarter payroll returns due (Aug. 10 if all deposits were paid). Forms 5500 due for pension or Keogh plans.
Sept. 15	3 rd quarter estimated tax payments due.
Oct. 15	Extended 2008 returns are late after today.
Today	Be sure to call if you have large changes to income or deductions!