

Tax Season

Everything you need to navigate through the busy season.

TOOLKIT



After the bustle of the holiday season, CPAs will be launched headlong into tax season. With the rapid changes taking place in the economy and regulatory world in response to the financial crisis, there is much to be wary of this year when filing for your clients. But, never fear! CalCPA's annual Tax Season Toolkit is here to help. As you meet with clients, research what's new in the tax codes and update software to provide the best service you can, spring ahead and confidently meet the only season that's never too late or early—tax season.

California Tax Tips

Net Operating Losses Suspended for 2008 and 2009

NOLs are suspended for both personal income and corporate taxpayers for 2008 and 2009. This applies to all California NOL provisions, including qualified small business and Enterprise Zone NOLs. An exception exists for taxpayers with less than \$500,000 in business income for the taxable year.

Suspended NOLs for 2008 and 2009 will be allowed additional carryover periods of two years and one year, respectively. Additionally, the NOL carryover period has been extended to 20 years for NOLs incurred in 2008 and forward.

A two-year NOL carryback is allowed for NOLs attributable to tax year 2011 and following years. NOL carryback amounts are limited as follows:

- 2011 NOL: 50 percent of NOL incurred.
- 2012 NOL: 75 percent of NOL incurred.
- 2013 NOL: 100 percent of NOL incurred.

No NOL carryback prior to tax year 2009 is allowed. Furthermore, no NOL carryback for Real Estate Investment Trusts will be allowed, and NOLs are limited for corporations involved in corporate equity reduction transactions as provided under the IRC rules for such transactions.

Business Tax Credit Information

Business tax credits (including the Enterprise Zone and Research Credits) may only offset up to 50 percent of the net tax for years 2008 and 2009. An exception exists for taxpayers with less than \$500,000 in business income for the taxable year.

Personal tax credits—including those for exemptions, status, renter's credit, adoption, dependent care and other state taxes paid—will not be limited and will be applied prior to any business credit limitation.

Up to two years will be added (depending on length of nonuse) to the carryover period of business tax credits that otherwise have

a limited carryover period. Both the Enterprise Zone and Research Credit have an unlimited carryover life.

In 2010, members within the same combined reporting group can make an irrevocable election to assign business credits earned by one member to another member. The election must be made on an originally filed return in the year assigned. Limitations as to the use of credits apply to the assignee as applicable to the assignor (e.g., the Enterprise Zone Credit will be limited to the assignee's zone income, computed in the same manner as the original credit). An election to assign credits can be performed for tax years beginning on or after Jan. 1, 2010. No further assignments of the same credit may be made to another taxpayer.

Estimated Payments Frontloaded for Tax Year 2009 and On

For tax years beginning on or after Jan. 1, 2009, estimated personal income and corporate tax payments will require quarterly installments of 30 percent each for the first and second installments, and 20 percent each for the third and fourth installments. For example, calendar year taxpayers will be required to pay 60 percent of their estimated tax by June 15, 2009, for the 2009 tax year.

Minimum Tax Only Payers for First Quarter

If only minimum tax is due the first quarter, 40 percent of the estimated tax is due with the second installment and 30 percent for each of the next two installments.

No Safe Harbor to Avoid Estimated Tax Penalty for High Net Worth Individuals

The safe harbor to avoid an estimated tax underpayment penalty for individuals who pay 100 percent of their prior year tax liability will no longer be available for those with \$1 million or more adjusted gross income for tax year 2009 and forward (\$500,000 in the case of a married individual filing a separate return).



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software support

Every major provider offers call-in, e-mail and online support. Here's a guide to some tax software support:

BNA Tax Management

(800) 372-1033

www.bna.com/tm/support.htm

e-mail: tm@bna.com

Creative Solutions Ultra Tax

(800) 968-0600

www.creativesolutions.com

thomson.com/support/

e-mail: www.creativesolutions.com

thomson.com/support/customer/

Drake Software

(828) 524-8020

<http://support.drakesoftware.com>

e-mail:

support@drakesoftware.com

Lacerte

(800) 933-9999

www.lacertesoftware.com/support/

e-mail: www.lacertesoftware.com/myaccount/email

support/AddEmail.aspx

GoSystem Tax ES

(800) 726-1040

<http://es.thomsonreuters.com/support/>

e-mail: [http://es.thomsonreuters.com/support/customer/](mailto:es.thomsonreuters.com/support/customer/)

ProSystemFX

(800) PFX-9998

<http://prosystemfxsupport.tax.cchgroup.com/>

[tax.cchgroup.com/](http://tax.cchgroup.com/CustomerSupport/CCH/csinq/default)

e-mail: [http://tax.cchgroup.com/CustomerSupport/CCH/](mailto:tax.cchgroup.com/CustomerSupport/CCH/csinq/default)
[csinq/default](http://tax.cchgroup.com/CustomerSupport/CCH/csinq/default)

TaxAct

(319) 373-4514

[www.taxact.com/tsupport/](http://www.taxact.com/tsupport/index.asp)
[index.asp](http://www.taxact.com/tsupport/index.asp)

e-mail: support@taxact.com

Individual Taxpayers Required to Remit Payments Electronically for Certain Amounts

All tax payments paid after Jan. 1, 2009 must be remitted electronically if an individual meets any of the following thresholds:

- Installment payment exceeds \$20,000.
- Total tax liability exceeds \$80,000 for years 2009 and forward.

A 1 percent penalty for noncompliance will be applied to the amount paid. An exception exists if reasonable cause and not willful neglect is established for the nonelectronic payment.

Exception to Personal Income Tax Underpayment Penalty

Tax due of less than \$500 for married and single individuals (\$250 for married filing separate) for tax years 2009 and forward are not subject to an estimated tax underpayment penalty.

Nonresident Group Filers Subject to Additional 1 Percent Tax

One or more nonresident partners, LLC members, S Corporation shareholders and directors can now elect to be included in a nonresident group return instead of filing their own individual nonresident tax return(s). They will be assessed a tax rate of 9.3 percent plus 1 percent on the portion of taxable income in excess of \$1 million.

Statute of Limitations Extended for Refunds of Taxes Paid to Other States

After 2008, taxpayers may file claims for refund or credit for taxes paid to other states within one year from the date the tax is paid to the other state even if the standard four-year statute of limitations period has lapsed.

Partnerships Now Subject to Real Estate Withholding at Source

For real property sales occurring after 2008, partnerships are now subject to the withholding at source requirements for California real estate. Amounts paid to out-of-state partnerships will be subject to withholding at the rate of 3.5 percent of the proceeds from the sale, unless the alternative withholding rate of 9.3 percent of the gain from the sale is elected.

The S corp alternative withholding rate is increased from 1.5 percent to 10.8 percent of the gain.

LLC Fee Must be Fully Paid by the 15th of the Sixth Month of the Tax Year

For years beginning on or after Jan. 1, 2009, LLCs must accurately estimate and remit the LLC fee for the full taxable year by the 15th of the sixth month of that year. For example, a 2009 calendar year taxpayer must estimate and

remit the full LLC fee by June 15, 2009.

Upon filing the LLC return April 15, 2010, any underpayment of the fee is subject to a 10 percent penalty. A safe harbor exception exists if the current estimated fee is equal to or greater than last year's fee paid.

Corporations with Understated Tax of \$1 Million or More Subject to 20 Percent Penalty

For taxable years 2003 and forward, an understatement of tax in excess of \$1 million is subject to an additional 20 percent penalty. The understatement is the difference between the tax shown on a timely filed return and amounts determined subsequent to the timely filing. For combined reporting group filings, the \$1 million threshold is based on the total tax liability. Once the \$1 million threshold is met, the 20 percent penalty applies to any understatement of tax.

The FTB has advised that this penalty will apply to tax increases due to FTB exam findings and reporting of federal exam changes to the state for the applicable years. A prepayment of the known and/or unknown potential tax understatement can be paid by May 31, 2009, to avoid the penalty for the applicable years.

Exceptions to the penalty include increases in tax due to changes in law, reliance on a FTB Chief Counsel Ruling, or incorrect penalty computations.

Expanded Use Tax Assessed on All Vehicles, Vessels and Aircraft Brought into State

The presumption that use tax is due on vehicles, vessels and aircraft purchased and held out of state less than 90 days has been extended to purchases held outside California for less than 12 months. This expanded provision applies to all out-of-state vehicle, vessel, and aircraft purchases after Sept. 30, 2008.

Information compiled by **Bob Reynolds, CPA**, partner with Moss Adams LLP specializing in California State and Local Tax. You can reach him at bob.reynolds@mossadams.com.

Federal Tax Tips

2008 Economic Stimulus Act:

The 2008 Economic Stimulus Act (P.L. 110-185) authorizes an additional depreciation deduction equal to 50 percent of the adjusted basis of "qualified property" that is placed in service *after* 2007 in tax years *ending* after 2007. This property must be acquired after 2007 and before 2009. Fiscal year taxpayers can claim this depreciation deduction on new IRS Form 4562-FY.

Qualified property is described in the June 2008 issue of *California CPA* (Page 31).

See discussion below for an election to claim additional *refundable* research and/or AMT credits instead of this bonus depreciation.

Luxury Autos and Other Listed Property Vehicles

The 2008 regular dollar caps for depreciation, including any IRC Sec. 179 expense deduction, on vehicles that are *not* “qualified property” placed in service during 2008 are as follows for 100 percent business use:

Passenger automobiles:	\$2,960
Light trucks or vans:	3,160

These caps also apply if a vehicle are qualified property, but an “election out” is made.

If these vehicles *are* qualified property and *no* “election out” is made, these 2008 dollar caps will be:

Passenger automobiles:	\$10,960
Light trucks or vans:	\$11,160

Enhanced Expensing

Under the old law, the maximum Sec. 179 expense deduction for property placed in service in tax years beginning in 2008 was \$128,000 (the \$125,000 set forth in Sec. 179(b)(1), adjusted for inflation). The 2008 Economic Stimulus Act increased this maximum to \$250,000 *only* for property placed in service in tax years *beginning* in 2008.

Under the old law, the maximum annual expense deduction generally was reduced, dollar-for-dollar, by the cost of Sec. 179 property placed in service in tax years beginning in 2008 that exceeded \$510,000 (the \$500,000 set forth in Sec. 179(b)(2), adjusted for inflation). The 2008 Act increased this investment limitation to \$800,000 *only* for property placed in service in tax years *beginning* in 2008.

Comment: This enhanced Sec. 179 deduction is not reflected on the new Form 4562-FY because the enhancement applies *only* for property placed in service in tax years *beginning* in 2008.

2007 Mortgage Forgiveness Debt Relief Act: New Exclusion for Discharges of Certain Mortgages

This Act (P.L. 110-142), signed into law Dec. 20, 2007, applies to debt discharged after 2006 and before 2010. It generally allows taxpayers to exclude from gross income discharges of up to \$2 million (\$1 million for married individuals filing separately) of debt that is secured by the taxpayer’s principal residence and was incurred in the acquisition, construction or substantial improvement of that residence. This type of debt is called qualified principal residence indebtedness (QPRI).

Note: The 2008 Emergency Economic Stabilization Act (P.L. 110-343), signed into law Oct. 3,



2008, extends this mortgage debt relief for three additional years.

Refinancing of such debt is eligible for this treatment to the extent that the refinancing amount does not exceed the amount of the refinanced debt.

The residence’s basis is reduced by the excluded income, but not below zero.

If any loan is completely or partially discharged and only part of the loan is QPRI, this exclusion applies only to so much of the amount discharged as exceeds the amount of the loan (determined immediately before the discharge) which is not QPRI.

This exclusion does not apply to the discharge of a loan if the discharge is on account of services performed for the lender or any other factor not directly related to a decline in the residence’s value or to the taxpayer’s financial condition.

The exclusion also does not apply to taxpayers in a Title 11 bankruptcy case.

The existing law’s exclusion for debt discharges of insolvent taxpayers, who are not in a Title 11 bankruptcy case, will not apply to a taxpayer eligible for this new mortgage forgiveness exclusion unless the taxpayer elects to apply the insolvency exclusion instead of the new exclusion.

Treatment of Mortgage Insurance Premiums as Interest

The 2006 Tax Relief and Health Care Act (P.L. 109-432) temporarily allowed taxpayers to treat qualified mortgage insurance as qualified residence interest, which is an itemized deduction. To be deductible, these premiums must be paid or accrued for qualified mortgage insurance obtained in connection with QPRI.

Qualified mortgage insurance is mortgage insurance provided by the Veterans Administration, the Federal Housing Administration or the Rural Housing Administration and private mortgage insurance [as defined by Section 2 of the 1998 Homeowners Protection Act (12 U.S.C. 4901), as in effect on Dec. 20, 2006].

Any amounts paid by the taxpayer for qualified mortgage insurance that is properly allocable to any mortgage, the payment of which extends to periods that are after the close of the tax year in which that amount is paid, are chargeable to a capital account and must be treated as paid in those periods to which they are allocated. However, no deduction is allowed for the unamortized premiums if the mortgage is satisfied before the end of its term. These two rules do not apply to premiums paid for qualified mortgage insurance provided by the VA or the RHA.

The amount of mortgage insurance premiums otherwise treated as qualified residence interest is reduced (but not below zero) by 10 percent of such amount for each \$1,000 (\$500 for married filing separately), or fraction thereof, that the taxpayer’s adjusted gross income (AGI) for the tax year exceeds \$100,000 (\$50,000 for married filing separately).

Raise Your Hand: Find a CPA

As tax season begins, don’t forget to register or update your information with CalCPA.org’s “Find a CPA.”

Find a CPA is among the most popular pages on the website, receiving thousands of hits each month. The feature has matched scores of taxpayers with the local CPAs that best suit their needs.

Your listing specifies not only where you practice, but also how you practice. Listings include services provided, industries served and languages spoken. Add your name to the directory—or update your profile if you’re already listed—at www.calcpa.org/CPAProfile.

Under the old law, this treatment did not apply to mortgage insurance contracts issued before 2007 or to premiums paid or accrued after 2007 or properly allocable to periods after 2007.

The new law extends this treatment for three years. Hence, it continues to apply if the mortgage insurance contract is issued after 2006 and the premiums are paid or accrued before 2011 and are not properly allocable to periods after 2011.

Residence Exclusion Liberalized for Surviving Spouse

Under the old law, the maximum \$500,000 gain exclusion was available only if a husband and wife filed a joint return for the year in which their principal residence was sold. A final joint return can be filed only for the year in which one of the spouses dies. Therefore, if a principal residence was sold after the year in which a spouse died, the surviving spouse's maximum exclusion was only \$250,000.

Under the new law, for sales and exchanges after 2007, surviving single spouses can qualify for the maximum \$500,000 exclusion if the sale (or exchange) occurs not later than two years after their spouse's death and the requirements for the \$500,000 exclusion under Sec. 121(b)(2)(A) were met immediately before the spouse's death.

Increased Penalties

For partnership returns required to be filed after Dec. 20, 2007, the penalty for failure to file is increased from five to 12 months and the per partner penalty is increased from \$50 to \$85.

For S corp returns required to be filed after Dec. 20, 2007, a new monthly penalty applies for failure to timely file an S corp return or failure to provide the information required to be shown on the return. This penalty, assessed against the S corp, is \$85 times the number of S corp shareholders during any part of the tax year for which the return was required, for each month (or fraction thereof) during which the failure persists, up to 12 months.

2008 Housing Assistance Tax Act: First-Time Homebuyer Credit

Under this new law, an individual taxpayer who is a first-time homebuyer of a principal residence in the United States is allowed a refundable tax credit equal to the lesser of:

- \$7,500 (\$3,750 for a married individual filing separately); or
- 10 percent of the residence's purchase price.

Generally, this credit is allowed for the tax year in which the taxpayer purchases the home. The credit is phased out for individuals with year-of-purchase modified AGI between \$75,000–\$95,000 or between \$150,000–\$170,000 for joint filers. Modified AGI is AGI increased by any amount excluded from gross income under Secs. 911, 931 or 933.

An individual is considered a first-time homebuyer if he or she (and if married, his or her spouse) had no present ownership interest in a principal residence in the U.S. during the three-year period ending on the date of the purchase of the principal residence to which this credit applies.

The credit is *not* allowed if:

1. The residence is financed from the proceeds of tax-exempt mortgage revenue bonds;
2. The taxpayer is a nonresident alien;
3. The taxpayer disposes of the residence or the residence ceases to be the principal residence of the taxpayer (and, if married, the taxpayer's spouse) before the close of a tax year for which the credit

otherwise would be allowable; or

4. The District of Columbia's homebuyer credit is allowable for the tax year the residence is purchased or for any prior tax year.

For purposes of this credit, the term "purchase" means any acquisition, but only if:

1. The property is not acquired from a related person; and



tax tip

Planning & Preparation

Don't forget CalCPA already houses various resources for you to prepare for tax season at CalCPA.org. From tax planning and update courses to relevant *California CPA* articles, it can all be found with other valuable resources at www.calcpa.org/Content/24157.aspx.

Also, CalCPA's Committee on Taxation provides up-to-date information and guidance to members on tax laws, programs and regulations. It also maintains liaison with the IRS, FTB and EDD staff, and reviews and responds to proposed tax legislation, regulations and revenue rulings.

Learn more at www.calcpa.org/Content/yourcommunity/tax.aspx.

2. The property's basis in the acquiror's hands is *not* determined:
 - In whole or in part by reference to the property's adjusted basis in the transferor's hands; or
 - Under Sec. 1014(a), relating to property acquired from a decedent.

For purposes of this credit, persons are treated as "related" if their relationship would result in the disallowance of losses under Secs. 267 or 707(b).

However, in applying Sec. 267(b) and (c) for this purpose, Sec. 267(c)(4) is treated as providing that an individual's family shall include only his or her spouse, ancestors and lineal descendants—thus excluding siblings.

The credit is recaptured ratably over 15 years, without any interest charged, beginning in the second tax year after the tax year in which the home is purchased.

If the taxpayer sells the home or if the home ceases to be used as the principal residence of the taxpayer or his/her spouse before the credit is completely recaptured, any remaining unrecaptured credit is due with the income tax return for the year in which the home is sold or ceases to be used as the principal residence.

However, such recapture cannot exceed the gain from the residence's sale if sold to an unrelated person. For this purpose, the gain is determined by reducing the residence's basis by any unrecaptured credit.

There is no recapture after the taxpayer's death. If the home is involuntarily converted, recapture is not accelerated if a new principal residence is acquired during the two-year period beginning on the date that the taxpayer disposes of the old home or it ceases to be used as the principal residence of the taxpayer (and, if married, the taxpayer's spouse).

In the case of a transfer of the residence to a spouse or to a former spouse incident to a divorce, the transferee spouse, and *not* the transferor

The **Tax Talk listserve** is an online community for posing and answering tax questions and passing on tax information. For details, visit www.calcpa.org/Content/listserve/taxtalk.aspx.

spouse, will be responsible for any future recapture.

This credit is available for qualifying home purchases after April 8, 2008 and before July 1, 2009—without regard to whether or not there was a binding contract to purchase before April 9, 2008.

An election is provided to treat a home purchased after 2008 and before July 1, 2009 as if purchased Dec. 31, 2008, to claim this credit for 2008 and establishing the beginning of the recapture period. Taxpayers may amend their returns for this purpose.

Additional Standard Deduction For State And Local Real Property Taxes

The Act increases an individual's standard deduction *only* for a tax year beginning in 2008 by the *lesser* of:

- The amount allowable as a deduction under Sec. 164(a)(1) for state and local real property taxes; or
- \$500, or \$1,000 for a married individual filing jointly.

No taxes deductible in computing AGI are taken into account in computing this increased standard deduction.

Note: The 2008 Emergency Economic Stabilization Act extended this additional standard deduction through 2009.

No Exclusion Of Gain On Sale Of Principal Residence For Nonqualified Use

Under this Act, gain from the sale or exchange of a principal residence *after 2008* that is allocated to periods of nonqualified use is *not* excluded from gross income. The amount of gain allocated to periods of nonqualified use is the amount of gain multiplied by the following fraction: Aggregate periods of nonqualified use during the period the property was owned by the individual divided by the period that the individual owned the property

A period of nonqualified use is any period *after 2008* during which the property is not used by the individual or his/her spouse or former spouse as a principal residence. For purposes of determining periods of nonqualified use, the following periods are *not* taken into account:

- Any period after the last date that the property is used as the individual's or his/her spouse's principal residence, regardless of use during that period; *and*
- Any period, not to exceed two years, that the individual is temporarily absent because of a change in place of employment, health or, to the extent provided in regulations, unforeseen circumstances.

The existing law's election for the uniformed services, Foreign Service and certain intelligence community employees is unchanged.

Since the exclusion does not apply to any gain attributable to post-May 6, 1997 depreciation, such gain is ignored in determining the gain allocated to nonqualified use.

See *California CPA*, October 2008, Page 37 for examples of this new provision.

Election To Accelerate Research And AMT Credits In Lieu Of Bonus Depreciation

For tax years ending after March 31, 2008, *corporations* otherwise eligible for bonus depreciation under Sec. 168(k) (see discussion above) may elect to claim additional *refundable* research and/or AMT credits instead of claiming this depreciation for "eligible qualified property" [defined in new Sec. 168(k)(4)(D)] placed in service after March 31, 2008.

The depreciation for qualified property is calculated for both

regular tax and AMT purposes using the straight-line method rather than the method that otherwise would be used absent

this new election.

Note: Rev. Proc. 2008-65 (IRB 2008-44, Nov. 3, 2008) contains guidance on this new election.

Other Developments:

Estate and Trust Deductions

The Supreme Court unanimously affirmed the Second Circuit Court of Appeals decision and rejected the contrary rationale of the Sixth Circuit Court of Appeals by holding that investment advisory fees paid by a trust are deductible only to the extent that they exceed 2 percent of the trust's adjusted gross income pursuant to Sec. 67(a).

Relief for Certain Late Elections

For tax years ending after Dec. 30, 2007, Rev. Proc. 2007-62 (IRB 2007-41, Oct. 9, 2007) provides another simplified method for taxpayers to request relief for late S corp elections.

This revenue procedure also provides a simplified method for taxpayers to request relief for a late S corp election and a late corporate classification election intended to be effective on the same date that the S corp election was intended to be effective. *User fees do not apply to corrective actions under Rev. Proc. 2007-62.*

See *California CPA*, December 2007, Page 16 for further details.

2009 Pension Plan Limitations

The IRS has unveiled cost-of-living adjustments applicable to dollar limitations for pension plans and other items for tax year 2009. Many of the pension plan limitations will change for 2009. For most of the limitations, the increase in the cost-of-living index met the statutory thresholds that trigger their adjustment.

For example, the limitation under Sec. 402(g)(1) on the exclusion for elective deferrals described in Sec. 402(g)(3) will increase from \$15,500 to \$16,500 for 2009. This limitation also affects elective deferrals to Sec. 401(k) plans and to the Federal Government's Thrift Savings Plan, among other plans.

For additional information, see IR-2008-118, Oct. 16.


2009 Inflation Adjustments

The value of each personal and dependency exemption will be \$3,650, a \$150 increase from 2008. The new standard deduction will be as follows:

	2009	2008
Married filing jointly	\$11,400	\$10,900
Single or married filing sep.	5,700	5,450
Head of household	8,350	8,000

The annual gift tax exclusion will be increased by \$1,000 to \$13,000 for 2009.

Other adjustments for more than approximately 36 other tax benefits are set forth in Rev. Proc. 2008-66.

Also, the maximum amount of earnings subject to the Social Security tax will increase to \$106,800 for 2009 (from \$102,000 for 2008). 

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