

Tax Season

Everything you need to navigate through the busy season.

TOOLKIT



With the coming of the new year, CPAs will be launched headlong into tax season. And the rapid changes taking place in the economy and regulatory world means there's much to be wary of. But, never fear! CalCPA's annual Tax Season Toolkit is here to help.

(Note: Information is as of Nov. 1, 2009. Details of other legislation, including the Worker, Homeownership, and Business Assistance Act of 2009 signed into law Nov. 6, were being reviewed as of presstime and are not included.)

California Tax Tips

Changes Effective in 2009

The governor called two special legislative sessions this year (in addition to general session) to reduce California's ongoing budget deficits. These sessions resulted in significant tax law changes for the 2009 tax filing period. Here is a recap.

Estimated Payments and Wage Withholding Steepens for 2010

For tax year 2009, estimated personal income and corporate tax payments increased from equal quarterly payments to required quarterly installments of 30 percent each for the first and second installments, and 20 percent each for the third and fourth installments.

For 2010, the required quarterly payments are 30 percent for the first, 40 percent for the second, no amount for the third and 30 percent for the final fourth quarter.

More importantly, this provision was expanded to include this accelerated withholding on all wages paid on or after Nov. 1, 2009.

Other withholding increases include 6.6 percent on "supplemental wages" and 10.23 percent on stock options and bonus payments paid on or after Nov. 1, 2009.

Back-up Withholding Conformity

For payments made on or after Jan. 1, 2010, California back-up withholding is required at a rate of 7 percent on such payments subject to federal back up withholding.

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; or
- 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.

Business Use Tax Registration for 'Qualified Purchasers'

Businesses that have at least \$100,000 in annual gross receipts

are required to register for a use tax account with the Board of Equalization. An annual filing is required to report and pay use tax on the total sales price of tangible merchandise purchased during the preceding calendar year.

The return for 2009 is due by April 15, 2010. This initial year will include calendar year 2007 and 2008 purchases, in addition to 2009. For more information, go to www.boe.ca.gov/news/pdf/1232.pdf.

Sales and Use Tax Rate Increased by One Percent

Beginning April 1, 2009, and effective through June 30, 2011, the state sales and use tax rate is increased by 1 percent.

Net Operating Losses Suspended for 2009

NOLs were suspended for 2008 and continue to be suspended for both personal income and corporate taxpayers for 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 is extended to 20 years for NOLs incurred in 2008 and forward.

Business Tax Credit Limitations Remain for 2009

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.

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.

Nonresident Group Filers Expanded

For tax year 2009, 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). The composite return filing requires withholding at the highest tax rate. For California source income in

excess of \$1 million, the 1 percent add-on tax will apply to the entire amount(s). For those nonresidents electing to be included in multiple composite returns, the add-on tax applies if the aggregate amount of California source income exceeds the \$1 million threshold.

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

For taxes paid to another state on or after Jan. 1, 2009, taxpayers may file claims for refunds or credits for taxes paid to other states within one year from the date the tax is paid, even if the standard four-year statute of limitations period has lapsed.

LLC Fee Prepay Required by the 15th of the Sixth Month

Starting in 2009 and forward, 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, for a 2010 calendar year taxpayer, the LLC fee is due by June 15, 2010.

Vehicle License Fee Increase

Effective May 19, 2009, the state Vehicle License Fee increased from 0.65 percent to 1.15 percent. The increase does not apply to certain truck trailers, semitrailers and other commercial vehicles. The rate increase is effective through June 30, 2011.

Individual Income Tax Rates Increased by .25 percent

For tax years beginning on or after Jan. 1, 2009, the individual tax rates increased by 0.25 percent. The increase applies to resident and non-resident individuals, to taxable estates and trusts, and to regular and alternative minimum tax rates.

The 0.25 percent rate increase, is effective through Dec. 31, 2010. Corporate tax rates (including S corporations) remain unchanged.

Dependent Credit Reduced by \$211 or More Per Dependent

For tax years beginning on or after Jan. 1, 2009, the dependent credit is reduced to an amount equal to the individual personal exemption credit. The 2009 credit amount is \$98 per dependent. Comparing that to the 2008 number, that results in a \$211 reduction in dependent credit.

The dependent credit reduction is effective through Dec. 31, 2010.

New Home Purchase Tax Credit

Individuals who purchase a new, never previously occupied, single-family residence between March 1, 2009–March 1, 2010, are eligible for a credit equal to the lesser of 5 percent of the purchase price or \$10,000 against their California personal income tax. The credit must be claimed in equal amounts over three successive tax years, beginning with the tax year in which the purchase is made.

Credits must be pre-approved before taxpayers claim it on their tax return. The Legislature limited available credits for all taxpayers to \$100 million. The available credits were fully used by July 2009. This credit is no longer available unless the Legislature takes further action.

Small-Business Hiring Tax Credit

For taxable years beginning on or after Jan. 1, 2009, a credit against individual and corporate income/franchise tax is granted in an amount equal to \$3,000, prorated as provided, for each qualified full-time employee hired during the taxable year by a qualified employer.

A “qualified employer” must have 20 or fewer employees on the last day of the preceding tax year and may only claim a credit on the net increase in “qualified employees” for the current year in comparison to last year. New businesses reflect all qualified employees as net increases.

Credits will cease to be granted in the calendar quarter when the total credits claimed on all state returns for all eligible years under this statute cumulatively total \$400 million.

Motion Picture Tax Credits

For taxable years beginning on or after Jan. 1, 2011, a credit against individual and corporate income tax is granted in an amount equal to a specified percentage of the qualified expenditures attributable to the production of a qualified motion picture in California. Credits must be certified in advance by the California Film Commission.

The credit allocation period is July 1, 2009–July 1, 2014. Credits are granted on a first-come, first-serve basis and are limited in total. The credits can be assigned to a member of the unitary group and, in some cases, sold to third parties. Elections are available to convert the credits for use against California sales or use tax in lieu of the income tax credit. The motion picture tax credit may present opportunities for some taxpayers.

California Designated Disaster Losses

Disaster loss treatment is allowed for losses sustained as a result of wildfires that occurred in Los Angeles, Orange, Riverside, San Bernardino, Ventura and Santa Barbara counties during October and November 2008, and May 2009.

California Nonconformity to Portions of IRC 382(h)

Internal Revenue Service Notice 2008-83 relating to treatment of deductions following an ownership change per Internal Revenue Code 382(h) shall not be applicable for California purposes.

Voluntary Contributions

The California Alzheimer’s Disease and Related Disorders Research voluntary check-off fund has been extended through 2014.

The California Fund for Senior Citizens voluntary contribution check-off has been extended through 2014.

Privileged Communication Granted

Privileged communication afforded between a client and an attorney is duly granted between a client and a CPA (or federally authorized practitioner) for noncriminal tax matters before the Franchise Tax Board, BOE and the Employment Development Department.

A special thanks to Assemblymember Fiona Ma, CPA and CalCPA’s Government Relations team for sponsoring this important provision for CPA tax practitioners and their clients.

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Federal Tax Tips

2009 American Recovery and Reinvestment Act Electing Longer NOL Carryback Period

The 2009 American Recovery and Reinvestment Act (P.L. 111-5), signed into law Feb. 17, 2009, allows an eligible small business (ESB) to *elect* to carryback an “applicable 2008 net operating loss” (NOL) for a period of three, four or five years.

An ESB is a corporation or partnership meeting IRC Sec. 448(c)’s gross receipts test for the tax year of the NOL or a sole proprietorship, which would meet this test if it were a corporation—but substituting \$15 million for \$5 million each place it appears in Sec. 448(c).

An applicable 2008 NOL is an NOL for any tax year *ending* in 2008 *or*, if the taxpayer *elects*, an NOL for any tax year *beginning* in 2008.



tax

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:** customer@bna.com**Creative Solutions Ultra Tax**

(800) 968-0600

www.creativesolutions.comthomson.com/support/**e-mail:** www.creativesolutions.comthomson.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:** http://my.lacerte.intuit.com/contact_us/contact_choice.aspx**GoSystem Tax ES**

(800) 726-1040

<http://es.thomsonreuters.com/support/>**e-mail:** <http://cs.thomsonreuters.com/support/customer/>**ProSystemFX**

(800) PFX-9998

<http://prosystemfxsupport.tax.cchgroup.com/>**e-mail:** <https://prosystemfxsupport.tax.cchgroup.com/contactus/default.asp>**TaxAct**

(319) 373-4514

www.taxact.com/tsupport/index.asp**e-mail:** https://www.taxact.com/tsupport/support_request.asp

Rev. Proc. 2009-26 (IRB 2009-19, May 11, 2009) provides that an ESB may elect a three, four or five-year carryback period by filing Form 1045, Form 1139 or an amended return.

Note: Although forms 1045 and 1139 ordinarily are due within 12 months after the tax year of the NOL, Sec. 172(b)(1)(H)(iii) requires that the taxpayer elect a three, four or five year carryback by the due date, *including extensions*, of the return for the tax year of the NOL. Thus, a taxpayer seeking to make a timely Sec. 172(b)(1)(H) election (which is irrevocable and can be made only for one tax year) using Form 1045, Form 1139 or an amended return *must file that form in advance of its ordinary due date.*

Rev. Proc. 2009-26 also prescribes how a taxpayer elects a three, four- or five-year carryback if the taxpayer previously filed an election to forgo the NOL carryback period for an applicable 2008 NOL or if the taxpayer is an owner of an ESB that is a partnership, an S corporation or a sole proprietorship.

Rev. Proc. 2009-26 *superseded* Rev. Proc. 2009-19, which contained more restrictive requirements for electing these longer carryback periods.

Bonus Depreciation

The new law extends the 50 percent first-year bonus depreciation allowed under the 2008 Economic Stimulus Act through 2009. (See *California CPA*, December 2008, pages 19-20).

The Act also extends this 50 percent bonus depreciation through 2010 for:

- Transportation property;
- Certain aircraft; and
- Longer production period property, which must have a recovery period of at least 10 years; be subject to the Sec. 263A uniform capitalization rules; and have an estimated production period exceeding one year and a cost exceeding \$1 million

Luxury Autos and Other Listed Property Vehicles

The new law extends through 2009 the following higher caps for vehicles that are qualified property (if "no election out" is made):

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

Election to Accelerate Research and AMT Credits in Lieu of Bonus Depreciation

This Act generally permits corporations to increase the research credit or minimum tax credit limitation by the bonus depreciation amount with respect to certain property placed in service in 2009 (2010 in the case of certain longer-lived property, transportation property and certain aircraft).

This new law applies with respect to extension property, which is defined as property

that is eligible qualified property solely because it meets the requirements under the extension of the special allowance for certain property acquired during 2009.

Under the Act, a taxpayer that has made an election to increase the research credit or minimum tax credit limitation for eligible qualified property, for its first tax year ending after Mar. 31, 2008, may choose *not* to make this election for extension property.

Also, the new law allows a taxpayer, that has *not* made an election for eligible qualified property for its first tax year ending after March 31, 2008, to make the election for extension property for its first tax year ending after 2008 and for each subsequent year.

In the case of a taxpayer electing to increase the research or minimum credit for both eligible qualified property and extension property, a separate bonus depreciation amount, maximum amount, and maximum increase amount is computed and applied to each group of property. In computing the maximum amount, the maximum increase amount for extension property is reduced by bonus depreciation for preceding tax years only for extension property

Enhanced Expensing

For tax years beginning in 2009, the Act continues the following higher limits in effect for tax years beginning in 2008:

- Max. Sec. 179 expense deduction: \$250,000
- Investment limitation: \$800,000

S Corp Built-In Gain Period

The new law temporarily shortens, from 10 to seven years, the holding period for assets subject to the built-in gains tax imposed after a C corp elects to become an S corp. This reduction applies for tax years beginning in 2009 and 2010 so that, for example, it would apply if S corp status were elected for a tax year beginning in 2002.

Procedures for Electing Deferral of COD Income on Repurchased Debt

For debt discharges in tax years ending after 2008, a taxpayer can elect under Sec. 108(i) to have cancellation of debt (COD) income from reacquiring an applicable debt instrument, after 2008 and before 2011, included in gross income ratably over five tax years beginning with 2014. (See Aug. 2009 *California CPA*, page 16.)

There also is no reduction of the taxpayer's tax attributes.

An applicable debt instrument is any debt instrument issued by a C corp or any other person in connection with the conduct of a trade or business. A debt instrument is any instrument or contractual arrangement constituting indebtedness under Sec. 1275.

Rev. Proc. 2009-37 (IRB 2009-36, Sept. 8, 2009) provides exclusive procedures for electing

to defer recognition of this COD income under Sec. 108(i). Partial elections are allowed, which may be very favorable for partnerships.

AMT Patch

Under this Act, the 2009 alternative minimum tax exemptions are:

- \$70,950 for joint returns and surviving spouses;
- \$46,700 for single taxpayers; and
- \$35,475 for married filing separately.

Also, the following existing exemptions continue:

- \$22,500 for estates and trusts; and
- \$40,000 for corporations.

Relaxed Preceding Year's Tax Safe Harbor for Qualified Individual's 2009 Estimated Tax

Under existing law, an individual's annual estimated tax is the *lesser* of:

- 90 percent of the current year's tax; *or* generally,
- 100 percent of the preceding year's tax.

However, if the preceding year's adjusted gross income (AGI) exceeds \$150,000 (\$75,000 for married filing separately), 110 percent of the preceding year's tax must be substituted for 100 percent of the preceding year's tax.

Nevertheless, the new law allows the required 2009 estimated tax for a "qualified individual" to be determined as the *lesser* of:

- 90 percent of the current year's tax; *or* generally,
- 90 percent of the preceding year's tax.

A qualified individual is any individual if:

- The individual's preceding year's AGI is less than \$500,000 (\$250,000 for married filing separately); and
- The individual certifies that more than 50 percent of the individual's preceding year's gross income was income from a small business.

A small business is one with less than 500 employees, on average, during the calendar year ending with, or within, the individual's preceding tax year.

Qualified Motor Vehicle Taxes

The Act provides that qualified motor vehicle taxes are deductible either as an itemized deduction or as an additional standard deduction.

Qualified motor vehicle taxes are any state or local sales or excise taxes imposed on the purchase of a qualified motor vehicle Feb. 16, 2009–Dec. 31, 2009. However, this deduction is limited to the tax on up to \$49,500 of the vehicle's purchase price.

A qualified motor vehicle is:

- A passenger automobile or light truck which is treated as a motor vehicle under Title II of the Clean Air Act, the gross vehicle weight rating of which is not more than 8,500 pounds;
- A motorcycle, the gross vehicle weight rating of which is not more than 8,500 pounds; and
- A motor home.

In addition, to be qualified, the original use of the motor vehicle must commence with the taxpayer.

This deduction is phased out for taxpayers with modified AGI, computed as described under the Making Work Pay Credit, between \$125,000 and \$135,000—or \$250,000 and \$260,000 on a joint return.

The deduction is not available if an election is made to deduct state and local general sales taxes in lieu of state and local income taxes.

Qualified motor vehicle taxes are not included in the cost of the acquired vehicle or, for a disposition, reduce the amount realized.

Qualified motor vehicle taxes also are deductible for AMT purposes.

Taxpayers who purchase a new motor vehicle in states that do not have state sales taxes are entitled to deduct other fees or taxes imposed

by the state or local government. The fees or taxes that qualify must be assessed on the purchase of the vehicle and must be based on the vehicle's sales price or as a per unit fee. (See IRS News Release IR-2009-60, June 10, 2009.)

Monthly Exclusion from Employee's Gross Income for Employer-Provided Transportation Fringe Benefits

Under the old law, an inflation-adjusted amount of up to \$120 a month, for 2009, could be excluded for qualified transportation fringe benefits that an employer provides through transit passes and vanpooling, as well as up to \$230 a month, for 2009, through employer-provided parking.

Effective from March 1, 2009 through Dec. 31, 2010, the new law increases the monthly exclusion for employer-provided transit passes and vanpooling to the same level as the exclusion for employer-provided parking, as follows:

	Transit Passes and Vanpooling	Parking
January–February 2009	\$120	\$230
March–December 2009	\$230	\$230

For 2010, the exclusion for transit passes and vanpooling will be the same as the exclusion for parking (adjusted for inflation).

Qualified Tuition Programs (Sec. 529 Plans)

Computer technology and equipment, as well as internet access and related services, qualify as higher education expenses under Sec. 529 plans for 2009 and 2010.

COBRA Subsidy

The new law allows an individual who is involuntarily separated from employment after Aug. 31, 2008 and before Jan. 1, 2010, to elect to pay 35 percent of his/her COBRA coverage and have it treated as paying the full amount.

The former employer will be required to pay the remaining 65 percent, but will be reimbursed by crediting those amounts against withheld income taxes and payroll taxes it is otherwise required to remit to the federal government. Income and other limitations on COBRA coverage apply.

Also see Aug. 2009 *California CPA*, page 15.

Child Tax Credit

Under the old law, this credit generally was refundable to the extent of 15 percent of the taxpayer's earned income exceeding \$10,000 (adjusted for inflation). Thus, for 2009, this threshold was \$12,550.

The new law decreases the threshold to \$3,000 for tax years beginning in 2009 and 2010, thereby increasing this credit's refundable portion.

Education Credit

For tax years beginning in 2009 and 2010, the Act renames the Hope Credit the American Opportunity Tax Credit and modifies this credit as follows:

- The maximum credit is increased to \$2,500 per eligible student per year for qualified tuition and related (QT&R) expenses;
- The definition of QT&R expenses includes course materials;
- The credit is allowed for the first four years of the student's post-secondary education in a degree or certificate program;
- The modified AGI range at which the credit is phased out is increased (modified AGI is computed as described next under the Making Work Pay Credit);
- The credit can be claimed against the AMT; and
- 40 percent of this credit is refundable.

Making Work Pay Credit

The new law allows eligible individuals for 2009 and 2010 a new *refundable* Making Work Pay Credit, for income tax purposes, equal to the *lesser* of:

- 6.2 percent of earned income; or
- \$400 (\$800 for joint returns).

This credit is reduced by 2 percent of the taxpayer's modified AGI exceeding \$75,000 (\$150,000 for joint returns).

Modified AGI is AGI increased by exclusions under:

- Sec. 911 for foreign earned income;
- Sec. 931 for income from sources within Guam, American Samoa or the Northern Mariana Islands; and
- Sec. 933 for income from sources within Puerto Rico.

An eligible individual is *any* individual *except*:

- A nonresident alien; and
- An individual for whom a dependency exemption is allowable to another taxpayer.

Estates and trusts also cannot claim the credit.

No credit is available unless a Social Security number is shown on the taxpayer's income tax return.

This credit is reduced by economic recovery payments and credits discussed below.

Economic Recovery Payments and Credits

The Act provided a one-time \$250 payment in May to individuals receiving Social Security, railroad retirement or veterans benefits.

This new law also allows a *refundable* \$250 income tax credit for *each* eligible taxpayer for 2009 only. An eligible taxpayer is any individual who receives a pension or annuity for service performed in the employ of the United States or any state or instrumentality thereof, which is not considered employment for Social Security/Medicare purposes.

No credit is available if:

- The taxpayer received the \$250 payment described above; or
- A Social Security number is not shown on the taxpayer's income tax return.

Unemployment Compensation

This Act excludes from gross income up to \$2,400 of unemployment compensation received in 2009.

Earned Income Tax Credit (EITC)

The new law increases this credit for tax years beginning in 2009 and 2010.

Under the old law, the EITC percentage for taxpayers with two or more qualifying children was 40 percent of the first \$12,570 of earned income. Under the new law, this percentage is increased to 45 percent of the first \$12,570 of earned income for taxpayers with three or more qualifying children for 2009 and 2010.

The new law also increases the threshold phase-out for married couples filing jointly to \$5,000 above the threshold phase-out amounts for singles, surviving spouses and heads of households for 2009 and 2010. This \$5,000 is indexed for inflation for 2010.

Energy Credits

The Act contains many provisions regarding energy credits, grouped in the following broad categories:

- Credits for energy-saving vehicles;
- Nonbusiness energy credits; and
- Alternative energy provisions.

The following credits, in particular, are discussed in the Aug. 2009 *California CPA*, pages 14-15:

- Tax credit for electric vehicles;
- Increased credit for alternative fuel vehicle refueling property; and
- Residential energy credits (secs. 25C and 25D).

2008 Emergency Economic Stabilization Act

Preparer Penalty Standards Retroactively Relaxed

This Act revises the definition of an "unreasonable position" and changes the standards for imposing the preparer penalty.

The preparer standard for undisclosed positions is reduced to "substantial authority," which conforms to the taxpayer standard. The preparer standard for disclosed positions is set at "reasonable basis."

Extension and Modification of AMT Credit Against Incentive Stock Options

The Act allows 50 percent of long-term unused minimum tax credits to be *refunded* over two years instead of 20 percent over five years. It also eliminates the AGI phaseout.

Tax-Free IRA Distributions to Qualified Charities

Existing Law: The 2006 Pension Protection Act provided an exclusion from gross income for otherwise taxable IRA distributions from a traditional or Roth IRA for qualified charitable distributions.

This exclusion may not exceed \$100,000 per taxpayer per tax year.

Distributions were eligible for the exclusion only if made on or after the date that the IRA owner attains age 70.5.

These distributions were taken into account for purposes of the required minimum distribution (RMD) rules, applicable to traditional IRAs, to the same extent that the distribution would have been taken into account under those rules if the distribution had not been made directly to the charity.

The exclusion applied only if a charitable contribution deduction for the *entire* distribution would be otherwise allowable (ignoring percentage limitations). Excluded distributions could not be claimed as charitable contribution deductions.

This tax benefit expired Dec. 31, 2007.

New Law: Effective for post-2007 distributions, the Act extends this PPA provision through Dec. 31, 2009.

2008 Worker, Retiree & Employer Recovery Act

This Act, signed into law Dec. 23, 2008, suspended RMDs from IRAs and annuities and employer-provided qualified retirement plans that are defined contribution plans.

Under the Act, no minimum lifetime or after-death distributions are required for calendar year 2009 from IRAs and employer plans that are defined contribution plans [within the meaning of Sec. 414(i)].

Other Developments

IRS Guidance on Preparer Penalties

Estate and Gift Tax Audits: A May 8, 2009, Interim Guidance Memorandum SBSE-04-0509-009 on preparer penalty procedures for estate and gift tax cases was issued by the IRS Small Business/Self-Employed Division. This interim guidance will be added to the *Internal Revenue Manual* at 4.25.1 by May 8, 2010.

The guidance reminds IRS estate tax attorneys of the importance that estate and gift tax return preparers abide by Secs. 6694 and 6695.

These IRS attorneys are urged to consider return preparer penalties during every transfer tax examination, but are cautioned that preparer penalties should not be proposed until after the estate or gift tax examination is complete at the group level. This guidance also warns IRS attorneys that return preparer penalties should never be discussed in the presence of the taxpayer as "each estate or gift tax

examination is separate and distinct from the return preparer penalty case.”

You can review this guidance at www.calcpa.org/IGM.

Employment Tax Audits

The IRS, in an Aug. 17, 2009 Interim Guidance Memorandum, outlined procedures for employment tax examiners to initiate an investigation in which the returns of clients of questionable tax return preparers are examined to determine whether preparer penalty injunctive action is required.

The memorandum (SB/SE-04-0809-047) from John Tuzynski, IRS chief of employment tax operations, to territory managers, group managers and other specialists in the IRS’s Small Business/Self-Employed Division, said that if during the course of an employment tax audit an examiner believes preparer noncompliance is “pervasive,” the official should consider opening a preparer action case.

This guidance is effective immediately.

Recent Cases Treat Losses from LLPs, LLCs as Nonpassive

In *Garnett v. Commissioner*, 132 TC No. 19, June 30, 2009, the Tax Court held the taxpayers did not own their interest in limited liability partnerships and limited liability companies as limited partners. Therefore, the losses from these interests were *not* presumptively passive under Sec. 469(h)(2).

This rationale was followed in *Thompson v. U.S.*, Ct Fed Cl, July 20, 2009 and, again, by the Tax Court in *Hegarty*, Summary Opinion 2009-153.

New IRS Guidance Extends Relief for Late Entity Elections

Rev. Proc. 2009-41 (IRB 2009-38, Sept. 28, 2009) provides guidance under Sec. 7701 for an eligible entity that requests relief for a late entity classification election filed with the applicable IRS campus (service center) *within three years and 75 days of the requested effective date of the entity’s election*. Rev. Proc. 2009-41 also provides guidance for eligible entities that do not qualify for relief under this revenue procedure and are required to request a letter ruling to request relief for a late entity classification election.

Disregarded Entity Not Disregarded

An individual organized a single-member LLC and contributed cash and marketable securities to it. Under the check-the-box regulations (Regs. Sec. 301.7701-3), the LLC was treated as a disregarded entity “for federal tax purposes.”

The individual then created trusts for her son and granddaughter and gave a 9.5 percent interest in the LLC to each trust. She also sold a 40.5 percent interest in the LLC to each trust in exchange for a secured promissory note.

A discounted value was used for gift tax purposes. The notes were discounted for lack of control and lack of marketability.

The IRS asserted that, since the LLC was a disregarded entity, it also should be disregarded for federal gift tax valuation purposes. Therefore, the LLC interests contributed to the trusts should, instead, be treated as gifts of the trusts’ proportionate shares of the cash and marketable securities.

The IRS also argued that the individual made an additional gift to each trust to the extent that the value of 40.5 percent of the LLC’s underlying assets exceeded the value of the trust’s promissory note.

In an Aug. 24, 2009 decision, the Tax Court held that these transfers to the trusts should be valued for gift tax purpose as transfers of interests in the LLC and not as transfers of a proportionate share

of the LLC’s assets. In a footnote, the court indicated another opinion will address other arguments regarding whether the step transaction doctrine applies and the appropriate valuation discounts, if any (see *Pierre v. Commissioner*, 133 TC No. 2).

IRS Guidance on Life Insurance Settlements

Rev. Rul. 2009-13 (IRB 2009-21, May 26, 2009) answers this question: What income is recognized upon the surrender or sale of life insurance contracts in the three situations described in that ruling?

Rev. Rul. 2009-14 (IRB 2009-21, May 26, 2009) answers this question: What are B’s consequences upon receiving death benefits or sales proceeds regarding a term life insurance contract that B purchased for profit in the three situations described in that ruling?

Sec. 6707A Penalties

The July 2009 issue of *California CPA* (Page 10) discussed penalties that could be imposed under Sec. 6707A. The IRS has suspended collection enforcement action through Dec. 31, 2009 on Sec. 6707A penalties regarding listed transactions where the annual tax benefit from the transaction is less than \$100,000 for individuals and \$200,000 for other taxpayers—since legislation is pending that will modify these penalties.

2010 Inflation Adjustments

The value of each personal and dependency exemption will be \$3,650, unchanged from 2009.

The new standard deduction will be:

	2010	2009
Married filing jointly	\$11,400	\$11,400
Single or married filing sep.	5,700	5,700
Head of household	8,400	8,350

The annual gift tax exclusion remains unchanged at \$13,000 for 2010.

Other adjustments for the remaining 35 other tax benefits are set forth in Rev. Proc. 2009-50 (IRB 2009-45, Nov. 9, 2009).


Also, the maximum amount of earnings subject to the Social Security tax remains unchanged at \$106,800 for 2010.

2010 Pension Plan Limitations

The following annual benefit limits remain unchanged for 2010:

Defined benefit plans	\$195,000
Defined contribution plans	49,000

The limits below are adjusted at the same time and in the same manner as the limit for defined benefit plans. Since that limit is unchanged, the following limits also are unchanged for 2010:

- The Sec. 401(k) plan limits under Sec. 402(g)(1) on the exclusion for elective deferrals described in Sec. 402(g)(3) will be \$16,500;
- The annual compensation limit under Secs. 401(a)(17), 404(l), 408(k)(3)(C) and 408(k)(6)(D)(ii) will be \$245,000;
- The dollar limit under Sec. 416(i)(1)(A)(i) for key employees in top-heavy plans will be \$160,000;
- The dollar amount under Sec. 409(o)(1)(C)(ii) for determining the maximum account balance in an employee stock ownership plan subject to a five-year distribution period will be \$985,000; and
- The dollar limit under Sec. 414(v)(2)(B)(ii) for catch-up contributions to an employer plan described in Secs. 401(k)(11) or 408(p) for anyone 50 and older will be \$2,500. 

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