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To Our Clients and Friends:

As we start another year it is again time to focus both on your 2009 return and on the future. The federal income tax environment is very favorable for 2009, but it is not likely to continue much longer. Now is the time to take advantage of the tax breaks that Congress has provided before they disappear. To get you started, we've included a few money-saving ideas here that you may want to put into action.

One way to reduce your tax liability is to look for additional deductions. Here's a list of suggestions to get you started:

**Make Charitable Gifts of Appreciated Stock.** If you have appreciated stock that you've held more than a year and you plan to make significant charitable contributions, keep your cash and donate the stock (or mutual fund shares) instead. You'll avoid paying tax on the appreciation, but will still be able to deduct the donated property's full value. If you want to maintain a position in the donated securities, you can immediately buy back a like number of shares. (This idea works especially well with no load mutual funds because there are no transaction fees involved.)

However, if the stock is now worth less than when you acquired it, sell the stock, take the loss, and then give the cash to the charity. If you give the stock to the charity, your charitable deduction will equal the stock's current depressed value and no capital loss will be available. Also, if you sell the stock at a loss, you can't immediately buy it back as this will trigger the wash sale rules, which means your loss won't be deductible, but instead will be added to the basis in the new shares.

**Maximize the Benefit of the Standard Deduction.** For 2009, the standard deduction is \$11,400 for married taxpayers filing joint returns. For single taxpayers, the amount is \$5,700. Currently, it looks like these amounts will be about the same for 2010. If your total itemized deductions are normally close to these amounts, you may be able to leverage the benefit of your deductions by bunching deductions in every other year. This allows you to time your itemized deductions so that they are high in one year and low in the next. You claim actual expenses in the year they are bunched and take the standard deduction in the intervening years.

For instance, you might consider moving charitable donations you normally would make in early 2010 to the end of 2009. If you're temporarily short on cash, charge the contribution to a credit card—it is deductible in the year charged, not when payment is made on the card. You can also accelerate payments of your real estate taxes or state income taxes otherwise due in early 2010. But, watch out for the AMT, as these taxes are not deductible for AMT purposes.

**Bunch Deductions Subject to an Adjusted Gross Income Limit.** Miscellaneous itemized deductions (such as unreimbursed employee business expenses) are deductible to the extent they exceed 2% of your adjusted gross income (AGI). (Your AGI is the number at the bottom of the first page of your return.) Medical expenses are deductible

only to the extent they exceed 7.5% of AGI. To lessen the affect of these AGI limitations, try to bunch your miscellaneous and medical expense deductions into every other year.

On 11/6/09, President Obama signed the new Worker, Homeownership, and Business Assistance Act of 2009 (the WHBAA) into law. The main reason for the legislation was to extend federal unemployment benefits. However, the WHBAA also includes important tax changes that affect individuals and businesses. This letter summarizes what we think are the key tax changes.

## **Homebuyer Credit Is Extended and Liberalized**

The familiar first-time homebuyer credit was previously scheduled to expire on 11/30/09. The WHBAA extends the deadline for another five months, to cover qualified purchases of U.S. principal residences that close by 4/30/10. However, if your new home is under contract on 4/30/10, the deadline to close the deal is extended to 6/30/10.

As was the case under prior law, the extended credit is still available to so-called first-time homebuyers, which means someone who has not owned a U.S. principal residence during the three-year period ending on the purchase date for the home that will serve as your new principal residence. If you're married, both you and your spouse must pass the three-year test. Also, the extended credit for a first-time homebuyer still equals the lesser of: (1) \$8,000 (\$4,000 if you use married filing separate status), or (2) 10% of the new principal residence purchase price.

**"Long-time" Homeowners Can Now Qualify for Smaller Credits.** The WHBAA effectively creates a new but less-lucrative credit for so-called long-time residents who buy replacement U.S. principal residences after 11/6/09. The new *long-time homeowner credit* equals the lesser of: (1) 10% of the replacement principal residence purchase price, or (2) \$6,500 (\$3,250 if you use married filing separate status). To qualify, you must have owned and used the same home as your principal residence for at least five consecutive years during the eight-year period ending on the purchase date for the replacement principal residence. If you're married, both you and your spouse must pass this test.

The new long-time homeowner credit is only available for a purchase that closes after 11/6/09 and by no later than 4/30/10 (or by 6/30/10 if your new home is under contract on 4/30/10).

**Phase-out Rules Are Liberalized** . Both the familiar first-time homebuyer credit and the new long-time homeowner credit are phased out as your income increases. However, the WHBAA significantly raises the phase-out ranges for purchases after 11/06/09.

The new phase-out range for unmarried individuals and married persons who file separately is between modified adjusted gross income (MAGI) of \$125,000 and \$145,000 (versus \$75,000-\$95,000 before the new law). The new phase-out range for married joint filers is between MAGI of \$225,000 and \$245,000 (versus \$150,000-\$170,000 before the new law).

**Credits Can Be Claimed on Prior-year Returns** . As under prior law, you can claim the credit (either the familiar first-time homebuyer credit or the new long-time homeowner credit) for a 2009 purchase on your 2008 Form 1040 (although that would

usually require filing an amended return at this point). You can also claim the credit for a 2010 purchase on your 2009 Form 1040.

**Homes Costing over \$800,000 Are Now Ineligible.** For purchases after 11/6/09, no credit is allowed for a home that costs over \$800,000.

**No More Credits for Youngsters or Dependents.** For purchases after 11/6/09, the homebuyer must be at least 18 years old on the purchase date to qualify for a credit. Also, a buyer who can be claimed as a dependent on someone else's Form 1040 for the year of purchase cannot claim the credit.

**New Anti-fraud Protections.** Under the new law, homebuyers must support credits claimed on 2009 and 2010 returns by attaching properly executed real estate settlement sheets to their returns. Also, the IRS can now automatically deny credits that appear to be claimed in error.

### **Five-year Carryback Privilege for Business Losses Is Extended and Liberalized**

The American Recovery and Reinvestment Act of 2009 (ARRA) that passed earlier this year allowed an eligible small business taxpayer to carry back a net operating tax loss (NOL) for either three, four, or five years. This is a beneficial exception to the two-year carryback rule that usually applies. However, the expanded NOL carryback privilege was only allowed to an *eligible small business* (ESB) for a calendar year 2008 NOL or for an NOL generated in a fiscal tax year that began or ended in 2008. To be an ESB, the business must have had average annual gross receipts of no more than \$15 million for the three-year period that ended with the loss year.

The new WHBAA now gives a similar expanded NOL carryback privilege to virtually all businesses, large and small alike. Specifically, the new expanded carryback deal is allowed for an NOL that is generated in a tax year that ends after 2007 and begins before 2010 (which means 2008 and 2009 for a calendar-year taxpayer). An NOL generated in one of these years can be carried back for three, four, or five years. Once again, this is a beneficial exception the two-year carryback rule that applies to most NOLs. However, the new election generally can only be made for one tax year that ends after 2007 and begins before 2010.

An election to take advantage of the new expanded NOL carryback privilege must be made by the due date (including any extension) of the return for the taxpayer's tax year that begins in 2009. Once made, the election is irrevocable.

**Small Businesses Can Use Expanded NOL Carryback Privilege for Two Years.** Say an eligible small business taxpayer took advantage of the prior-law expanded NOL carryback privilege (allowed by the ARRA) for its calendar-year 2008 NOL. If the business also has an NOL for calendar-year 2009, it can take advantage of the new expanded carryback privilege allowed by the new law for its 2009 NOL. In other words, the taxpayer can benefit twice from the expanded NOL carryback privilege: once with the prior-law deal for its 2008 NOL and again with the new deal for its 2009 NOL.

**Limitation on NOL Carried Back to Fifth Preceding Year.** If your business makes a new election under the WHBAA to carry back an NOL to the fifth preceding tax year, the amount carried back to that year is limited to 50% of the taxable income for that year.

## FUTA Tax Surcharge Extended

Through the end of 2009, the Federal Unemployment Tax Act (FUTA) imposes a maximum FUTA tax rate of 6.2% on the first \$7,000 of an employee's annual wages. The 6.2% rate actually has two parts: a permanent 6% rate plus a temporary surtax of .2%. The WHBAA extends the .2% surtax for another 18 months, through 6/30/11.

## Higher Failure-to-file Penalties for Partnerships and S Corps

The WHBAA hikes the penalty for failing to file a partnership return on Form 1065 , or failing to provide required information on Form 1065 , from the current \$89 per partner per month to \$195 per partner per month. The penalty can be assessed for up to 12 months. The higher penalty applies to Form 1065 required for tax years beginning after 12/31/09.

**The WHBAA also hikes the penalty for failing to file an S corporation return on Form 1120S, or failing to provide required information on Form 1120S , from the current \$89 per shareholder per month to \$195 per shareholder per month. The penalty can be assessed for up to 12 months. The h**

## Ideas for Investments

**Harvest Capital Losses.** If you are sitting on some investments that have dropped in value since you acquired them, now might be a good time to dump part or all of them to cut your tax bill. You can deduct capital losses up to the amount of any capital gains that you'll have for the year (for example, from mutual fund distributions or sales of stocks or bonds). Also, you can claim up to an additional \$3,000 of losses (\$1,500 if you're married but filing a separate return) against your other income. Any losses in excess of these amounts carry over to next year.

If you're selling less than your entire interest in an investment, you can maximize the amount of deductible loss that you realize by telling your broker or mutual fund company to sell the highest basis shares first (and then have them confirm your instructions in writing within a reasonable time after the sale). In addition, if you think your investments that are currently underwater are poised for a comeback, you can buy them back after taking a loss as long as you don't reacquire them within 30 days before *or* after the sale.

**Take Advantage of 0% Capital Gains Rate before It is Too Late .** For 2009, the federal income tax rate on long-term capital gains and qualified dividends is 0% when they fall within the 10% or 15% regular federal income tax rate brackets. This will be the case to the extent your taxable income (including long-term capital gains and qualified dividends) does not exceed \$67,900 if you're married and file jointly (\$33,950 if you're single). This 0% rate will likely continue to apply in 2010, but is scheduled for repeal in 2011.

While your income may be too high to benefit from the 0% rate, you may have children, grandchildren, or other loved ones who can. If so, consider giving them some appreciated stock or mutual fund shares, which they can then sell and pay 0% tax on the resulting long-term gains. Gains will be long-term, as long as your ownership period plus the gift recipient's ownership period is over a year. Giving away stocks that pay dividends is another tax-smart idea. As long as the gift recipient is in the 0% or 15% regular tax rate bracket, the dividends will be federal-income-tax-free.

Watch out though, if during 2009 you give away assets worth over \$13,000 to an individual gift recipient, the excess will generally eat into your \$1 million lifetime federal gift tax exemption and your \$3.5 million federal estate tax exemption. However, you and your spouse can together give away up to \$26,000 per recipient without any adverse effects on your respective gift and estate tax exemptions. Also, if you give securities to someone who is under age 24, the Kiddie Tax rules could potentially cause some of the resulting investment income to be taxed at the parent's higher rates instead of at the gift recipient's lower rates. That would defeat the purpose. Please contact us if you have questions.

**Secure a Deduction for Nearly Worthless Securities.** If the dismal economy has left you with securities that are all but worthless with little hope of recovery, you might consider selling them before the end of the year so you can capitalize on the loss this year. You can deduct a loss on worthless securities only if you can prove the investment is completely worthless. Thus, a deduction is not available, as long as you own the security and it has any value at all. Total worthlessness can be very difficult to establish with any certainty. To avoid the issue, it may be easier to just sell the security if it has any marketable value. As long as the sale is not to a close family member, this allows you to claim a loss for the difference between your tax basis and the proceeds (subject to the normal rules for capital losses and the wash sale rules restricting the recognition of loss if the security is repurchased within 30 days before or after the sale).

## Ideas for Your Business

**Take Advantage of Temporary Tax Breaks for Equipment and Software Purchases .** If you have plans to buy a business computer, office furniture, equipment, vehicle, or other tangible business property, you might consider doing so before year-end to maximize your 2009 deductions. Here's why:

- *Bigger Section 179 Deduction.* Your business may be able to take advantage of the temporarily increased Section 179 deduction. Under the Section 179 deduction privilege, an eligible business can often claim first-year depreciation write-offs for the entire cost of new and used equipment and software additions. For tax years beginning in 2009, the maximum Section 179 deduction is a whopping \$250,000. However, the allowable deduction is reduced dollar-for-dollar to the extent the amount of qualifying property placed in service during the year exceeds \$800,000. For tax years beginning in 2010, the maximum deduction is estimated to drop back to about \$134,000, with reductions estimated to begin when more than \$530,000 of qualifying property is placed in service.
- *50% First-year Bonus Depreciation.* Above and beyond the bumped-up Section 179 deduction, your business can also claim first-year bonus depreciation equal to 50% of the cost (reduced by the Section 179 deduction) of most new (not used) equipment and software acquired and placed in service by December 31 of this year. The 50% first-year bonus depreciation break will expire at year-end unless Congress takes further action.

**Avoid the Hobby Loss Rules.** A lot of businesses that are just starting out or have hit a bump in the road thanks to the dismal economy may wind up showing a loss for the year. The last thing the business owner wants in this situation is for the IRS to come knocking on the door arguing the business's losses aren't deductible because the activity is just a hobby for the owner. Surprisingly, the IRS has been fairly successful recently in making this argument when it takes taxpayers to court. Thus, if your business is expecting a loss this year, we should talk before year-end to make sure we do everything possible to maximize the tax benefit of the loss and minimize its economic impact.

## Ideas for the Office

**Maximize Contributions to 401(k) Plans.** If you have a 401(k) plan at work, it's just about time to tell your company how much you want to set aside on a tax-free basis for next year. Contribute as much as you can stand, especially if your employer makes matching contributions. You give up "free money" when you fail to participate to the max for the match.

**Take Advantage of Flexible Spending Accounts (FSAs).** If your company has an FSA, before year-end you must specify how much of your 2010 salary to convert into tax-free contributions to the plan. You can then take tax-free withdrawals next year to reimburse yourself for out-of-pocket medical and dental expenses and qualifying child care costs. Watch out, though, FSAs are "use-it-or-lose-it" accounts—you don't want to set aside more than what you'll likely have in qualifying expenses for the year.

**Adjust Your Federal Income Tax Withholding.** If it looks like you are going to owe income taxes for 2009, consider bumping up the Federal income taxes withheld from your paychecks now through the end of the year. When you file your return, you will still have to pay any taxes due less the amount paid in. However, as long as your total tax payments (estimated payments plus withholdings) equal at least 90% of your estimated 2009 liability or, if smaller, 100% of your 2008 liability (110% if your 2008 adjusted gross income exceeded \$150,000; \$75,000 for married individuals who filed separate returns), interest and penalties will be minimized, if not eliminated.

## Ideas for Seniors Age 70 1/2 or Older

**Make Charitable Donations Directly from Your IRAs .** If you've reached age 70 1/2, you can arrange to transfer up to \$100,000 of otherwise taxable IRA money to the public charity of your choice (such as your church or other favorite charity). The distribution is federally income tax free. You don't get to claim it as an itemized deduction on your Form 1040. However, the tax-free treatment equates to a 100% write-off, and you don't have to itemize your deductions to get it. Additionally, since it is tax-free, it may reduce your Social Security benefits subject to tax. Be careful though—to qualify for this special tax break, the funds must be *transferred directly* from your IRA to the charity (you can't receive cash and then donate it). Also, this provision expires at the end of 2009 unless Congress extends it. So, this could be your last chance.

## Environmentally Friendly Ideas

**Make Energy Efficiency Improvements to Your Home.** A great way to cut energy costs and save up to \$1,500 in federal income taxes this year is to make energy efficiency improvements to your principal residence. Basically, if you install energy efficient insulation, windows, doors, roofs, heat pumps, hot water heaters or boilers, or advanced main air circulating fans to your home during 2009 or 2010, you may be entitled to a tax credit of 30% of the purchase price, up to a maximum credit of \$1,500. For 2009, the credit is allowed against the AMT. However, unless Congress changes the rules, this will not be the case for 2010. If there is any possibility you'll be subject to AMT next year, you may want to make these improvements this year.

**Purchase a Qualifying Hybrid or Lean Burn Technology Vehicle** If you have been considering purchasing a new hybrid or lean-burn technology vehicle, now may be a good time to do so. First of all, as we discussed earlier, the sales tax paid on the vehicle may be deductible. Secondly, purchasing a qualifying new (not used) vehicle this year may

reap you an alternative motor vehicle tax credit from around \$900 to \$3,000, depending on the vehicle, which in 2009 can offset the AMT. However, not all 2009 purchases qualify as credits are phased out once the manufacturer has sold over 60,000 qualifying vehicles. Because of this rule, no credits are allowed for 2009 purchases of Toyota, Lexus, and Honda hybrids and only reduced credits are available for Ford and Mercury hybrids. So far, full credits are still allowed for hybrids made by Chrysler, GM, Mazda, and Nissan. Full credits are also allowed for lean-burn technology vehicles made by Mercedes, Volkswagen, BMW, and Audi. Give us a call if you want to know the available credit amount for a specific hybrid or lean-burn technology vehicle.

## Ideas for Your Estate

The federal estate tax exemption for 2009 is \$3.5 million. For 2010, the federal estate tax is supposed to be repealed—but just for that one year. It now seems clear that if the promised repeal ever happens at all, it will just be for 2010. The more likely scenario is that we will continue to have a federal estate tax for 2010 and beyond with a \$3.5 million or somewhat larger exemption. Therefore, planning to avoid or minimize the federal estate tax should still be part of your overall financial game plan.

**Make Annual Gifts to Reduce Your Estate.** Whittling your estate down by making annual gifts continues to be a tax-smart strategy. If you have some favorite relatives or unrelated persons, you and your spouse both can give each of them up to \$13,000 this year. These gifts will reduce your estate tax exposure without any adverse gift tax effects. Making multiple gifts over multiple years can dramatically reduce your exposure to the estate tax. So, the sooner you start an annual gifting program, the better.

**Capitalize on Depressed Security Values to Boost Giving Power.** The current depressed security values may mean that more assets can be transferred within the limits of the gift tax annual exclusion amount (\$13,000 for 2009) and the lifetime applicable exclusion amount (\$1 million). Thus, if a security's value is expected to participate in the inevitable (we hope) economic recovery (and especially if the security is expected to significantly appreciate) this may be the perfect time to give the security to the intended recipients. However, do not give away loser shares (currently worth less than what you paid for them). Instead, sell the shares, and take advantage of the resulting capital loss, and then give away the cash.

## Conclusion

With a little effort and some careful planning, it's possible your tax liability can be significantly reduced. We're available to assist you in this planning process any way we can. Please don't hesitate to contact us with questions or ideas on reducing your tax bill.

Best regards,

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