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Annual Individual Tax Newsletter

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Tax Update Newsletter for Individuals - 2009

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The financial crisis continues to bring changes to our economy and tax rules. This newsletter covers the major changes and a review of items that are relevant to taxpayers in this area.

New Tax Law Changes:

Making Work Pay Credit – This credit can be as much as \$400 for an individual or \$800 for a jointly filed return. If you earn more than \$95,000 (filing Single) or more than \$195,000 (filing Jointly) you will not qualify for the credit. This credit was designed to benefit taxpayers throughout 2009 by changing the withholding tables instead of issuing a single check like in the past. Unfortunately, this change to the tax tables will more likely result in many taxpayers with a balance due for 2009.

Ponzi Scheme Losses – A new law is allowing taxpayers to take a theft loss in 2009 for investment fraud. If the taxpayer invested their own cash and the loss is generated from a criminal fraud or embezzlement similar to the Madoff scheme, the loss will be deducted from ordinary income. The loss is deductible in the year it is discovered and not limited to the \$3,000 capital loss per year rules.

New and Enhanced Home Buyer's Credit – This credit has changed for 2009 into two different credits: 1) Existing Home Owners that have lived in and owned their home for at least 5 out of the last 8 years, and 2) First Time Home Buyers. Both of these credits have income limitations so please check with our office for further details to see if you qualify.

Existing Home Owners now have the opportunity to purchase a new home if they have owned their current home for at least 5 out of the last 8 years and receive a credit up to **\$6,500** or 10% of the purchase price of the home. The total purchase price of the home can not exceed \$800,000. The new principal residence must be purchased after November 6, 2009 and on or before April 30, 2010 (or purchased by June 30, 2010 with a binding sales contract signed by April 30, 2010).

The First Time Home Buyer Credit is available on the purchase of a principal residence for individuals who have not had an ownership interest in a home during the 3-year period ending on the date of the purchase of the new home. This does not apply to home equity loans not used to buy, build or improve the primary residence. The credit is increased to a maximum of **\$8,000** or 10% of the purchase price for homes purchased between January 1, 2009 and April 30, 2010 and the credit does not have to be paid back to the IRS in the future (this differs from the 2008 \$7,500 credit).

Foreclosures & Bankruptcy – In general, if a taxpayer is forgiven or absolved of their debt (credit cards or mortgages), the debt becomes taxable income. The Mortgage Forgiveness Debt Relief Act will exclude debt forgiveness from taxable income if the taxpayer's debt was a mortgage from their principal residence and the debt was used to buy, build, or improve their residence (home equity debt does not qualify). This is for years 2007, 2008, and 2009.

Capital Gains:

Zero Capital Gains Rate – The capital gains rate is zero in 2009 for taxpayers in the lowest tax bracket. For those in the 15% tax bracket, their capital gains rate will be 10% and for all others the capital gains rate will be 15%. Be sure to review your capital gains and losses realized for this year. If you have net gains, take offsetting losses of equal value to make them tax free. You must actually sell the stock or fund to take advantage of the losses. The maximum net allowable capital loss in one year is \$3,000. If your loss is greater than \$3,000, the excess is carried forward to future tax years.

Increased Capital Gains Rate for the Future – There has been no legislation established to increase the capital gains rate at this time, but it is highly anticipated that the 2010 year will see this change enacted. We can't predict the future but encourage clients to move any large sales that are subject to capital gains tax into the 2009 year if possible. In 2011 the low rates go away UNLESS there is legislation to change them; they will revert back to pre-2001 rates.

Did you sell any stocks or mutual funds? You will need to research your purchase price, the number of shares purchased, and the date of purchase. Start with your own records or contact your financial institution for the history of purchases. If this is not possible, the internet is a great resource – use <http://www.bigcharts.com> to research the basis (purchase price) of your shares. Don't forget that reinvested dividends are part of your costs. There will be additional charges if we have to research and reconstruct the basis details.

Retirement:

Converting a Traditional IRA to a Roth IRA – In 2010 anyone can convert money they've already invested in a traditional IRA into a Roth IRA. There will be no adjusted gross income limit for the 2010 year. That is a change from current law where the IRA conversion is not allowed if your adjusted gross income is \$100,000 or greater when you convert to a Roth. You will owe tax on whatever amount you have converted from the traditional IRA to the Roth IRA. After paying the tax on the conversion today, you will never pay any tax in retirement or when it is withdrawn. The good news is that if you convert in 2010, the tax bill can be spread over two years. Please contact us before a planned conversion to discuss the tax implications.

IRAs – Putting money into a traditional individual retirement account (IRA) is a good idea but can be very tricky. If you are eligible to participate in a retirement plan with your employer or your income exceeds \$89,000 (Married Filing Jointly) or \$55,000 (Single) you are limited to how much is deductible. You may want to make the contribution anyway, but it will be necessary to track the non-deductible amounts on Form 8606. If the non-deductible amounts are not tracked, you could end up paying tax on the money twice. We are not able to help you track the non-deductible contributions unless you report the contribution amounts to us.

The Roth IRA has become very appealing because the distributions will not be taxed when withdrawn, as long as the money is in the account for at least 5 years and the taxpayer is age 59 ½ at the withdrawal date. You are not eligible to make a Roth contribution once your adjusted gross income exceeds \$176,000 (Married Filing Jointly) or \$120,000 (Single). If you have concerns about the taxation of a distribution or limits for contributions, please contact our office.

The maximum contribution amount for both traditional IRAs and Roth IRAs is \$5,000 if you are under 50 years of age, plus an additional \$1,000 if you are age 50 or older.

Retirement Contributions – Contributing to a retirement account through your employer is always a great

tax break. The income and earnings are non-taxable in the current year but become taxable upon withdrawal. Generally, there is a 10% penalty if the money is withdrawn before age 59 ½.

The maximum deferral for 401(k) and 403(b)s:

	Under the age of 50	50 or older by December 31
2009 year	\$16,500	\$22,000
2010 year	\$16,500	\$22,000

Check with your HR Department to increase your contribution amounts in January 2010. Please let me know if you decide to do an early withdrawal from a qualified retirement account prior to making the withdrawal. You will lose at least 30% and sometimes as much as 50% to taxes and penalties on any early withdrawal.

Social Security Earnings – If you are between the age of 62 and full retirement age (see the social security administration’s website to calculate your full retirement age) and are drawing social security benefits, the maximum amount of earnings you can make in 2009 is \$14,160. The maximum amount that a taxpayer’s wages can be taxed for social security purposes in 2010 is \$106,800.

If you are looking toward retirement, go to <http://www.ssa.gov/retire> on the Internet to access the Social Security Retirement Planner, which will walk you through the retirement application process and offer information on issues to consider when applying for benefits. You will find online calculators to help you through the process of estimating future earnings based on past and present earnings.

Real Estate:

Did you refinance this year? Refinancing may increase your taxes. Paying a lower interest rate will decrease your mortgage interest write-off, which increases taxable income. Be sure to bring in your refinance settlement sheet for the preparation of your tax return. Any points paid at refinancing are considered to be mortgage interest and will be written off over the length of the loan using an amortization schedule. If you had a prior refinance with points, the remaining unamortized points can be taken as a deduction only if you have changed lenders.

Home Equity Interest – There are limits on the deductibility of home equity interest. A taxpayer may not deduct all of the interest if the principal amount of the home equity loan is greater than \$100,000 if the money from the loan was used for a purpose other than to buy, build or improve a qualified home. Please let us know if you have a home equity loan, as there are other limitations to this deduction. If you used your loan proceeds to make improvements to your home this limitation may not apply.

Home Mortgage Insurance Premiums – Mortgage insurance premiums are an allowable itemized deduction subject to income limitations. The mortgage company should be reporting this information on Form 1098 along with the mortgage interest paid.

Rental Properties – Owning a rental property that generates a loss will not give you a current-year tax break if your income is greater than \$150,000 (less if married filing separately). Once your adjusted gross income reaches \$100,000, your losses will begin to phase out as a current-year deduction. No losses are allowed in the current year if your adjusted gross income exceeds \$150,000 unless you are in the business of real estate management. The disallowed losses will carry forward until the year that your income drops below \$150,000, you sell the property or you have passive income. Please contact our office prior to signing any contracts if you intend on selling your rental so we can review the tax consequences.

Tax Tip: Like Kind Exchanges – To avoid paying capital gains on the sale of your rental, you can engage in a ‘Like Kind Exchange’ in which you purchase another rental and swap properties. The capital gains

are deferred until you sell the replacement property. This does not apply to personal residences. There are VERY stringent requirements when conducting an exchange so it is critical that you contact us prior to signing contracts.

Sale of Personal Residence – In general, if you have both lived in and owned your personal residence for 2 of the last 5 years and the gain is not larger than \$500,000 (Married Filing Jointly) or \$250,000 (Single), then there is no capital gains tax due on the sale. If you have been in the home less than 2 years, you may qualify for a reduced exclusion and still not be subject to the gains tax. The reduced exclusion is available for medical purposes, changing jobs, and unforeseen circumstances (such as death, divorce, multiple births, and disasters). Please let me know if you are selling your personal residence so we can review the tax consequences prior to signing any contracts.

Military – If you are an active member of the military, with the US Foreign Services, or employees of the US intelligence community you may have as many as 15 years instead of 5 to qualify for the primary residence exclusion.

Deductions & Credits:

Moving – The moving deduction is available only if you have changed jobs and moved at least 50 miles. The new job and home must be more than 50 miles from the former job and home. Remember to always inform the IRS of a change of address. This can be done by completing Form 8822. The form can be found at the IRS Web site <http://www.irs.gov>.

Mileage Rates – The standard business mileage rate for the 2009 year is 55 cents per mile. Mileage for charity and volunteer work remains at 14 cents per mile.

Charity – Taxpayers are required to have receipts, bank records, or written documentation for **all** charitable contributions. **No deductions for cash** contributions are allowed without receipts; therefore, you will need a receipt if you give cash! Be sure to give us a copy of your receipts for any donations.

All non-cash items (clothing, household items, appliances, etc) must be in good condition or better for contributions made after 8/17/06. Written documentation is required to take this deduction and the IRS has been asking for this documentation in their examination process. Since we have no knowledge of the condition of the items you donate, it will be necessary for you to place a detailed description and value on the receipt for any donated items. **We cannot place a value on any blank receipts we receive and you will receive no deduction.** Go to www.satruck.org for the Salvation Army Valuation Guide to value your donated goods. Valuations above \$5,000 require an appraisal.

Donating Vehicles – If you give away a vehicle and the fair market value is greater than \$500, you will need written documentation from the charity stating the amount the charity received when they resold your vehicle. You will only be allowed a deduction for the amount received in the sale and not the blue book value unless the charity is using the vehicle instead of placing it for sale. If you donated a vehicle, you will need to get Form 1098-C from the charity.

Donating Appreciated Stock to Charity – As an example: If you purchased stock for \$1.00 per share and the fair market value is now \$10.00 per share and you held the stock for more than one year, you can avoid paying capital gains on the \$9.00 increase in price by gifting it to a qualified charity. Not only that, you receive a charitable contribution deduction for the fair market value of \$10.00 per share when you only had an out-of-pocket expense of \$1.00 per share. This transaction must be well documented with a letter from the charitable organization and proof of the fair market value on the date that it was gifted.

Child Credit – The maximum child credit for 2009 is \$1,000 per child under the age of 17. This credit will not be available to some taxpayers due to their income level.

Dependent Day Care Credit – The maximum childcare expense used in this calculation for one child is \$3,000 and for two or more children is \$6,000. Depending upon a taxpayer's income, the maximum credit for one child could be \$1,050 or \$2,100 for two or more children.

College tuition – Taxpayers have both a higher education deduction and a higher education credit available for college expenses – you choose to take whichever is higher. The deduction is maximized at \$4,000 and the credit has increased for 2009 to be as high as \$2,500. The tax return must be prepared both ways in order to determine which one provides the greater tax break to the taxpayer. Taxpayers are not allowed to claim both the deduction and the credit in the same year for the same student. The education expenses must be incurred during the year and cover tuition and fees (not books, room, board, or activity fees). There are two available credits. The first is the Hope Credit for 1st, 2nd, 3rd, and 4th year students who attend school at least half time. The second is the Lifetime Learning Credit, which is available for any student. There is no limit to the number of years that the Lifetime Learning Credit can be claimed, and it is available to all individuals.

Other Tax Topics:

Increased Age to Kiddie Tax – Any child under the age of 18 **and** your full-time college student (ages 18 to 23) who have unearned income (interest, dividends, and investment income) greater than \$1,900 will be taxed at his or her parent's tax rate. Please check with us if you are unsure whether your child needs to file an income tax return based on his or her earned or unearned income. It may seem odd, but it is possible that a newborn is required to file a return.

CAUTION – Check with your college age student to make sure they have not filed and claimed themselves on their own income tax return before you claim them as a dependent on your return.

Inheritance – In general, money and assets received through an inheritance are not taxable income. There is an exception for annuities and IRA accounts. If you have received a distribution from an IRA or annuity due to a death, you will most likely be taxed on the income on your individual income tax return. Please contact our office if you inherit an IRA or annuity so we can look at how this will affect your current tax liability.

Gifts – Giving a gift to an individual or family member is not a tax deduction, but instead can cause the individual giving the gift to owe tax. The IRS has limits as to the amounts an individual can give before the taxpayer is required to file a gift tax return and possibly owe gift tax on the money. This amount is \$13,000 for 2009. As a taxpayer, you can give up to \$13,000 to any other individual before you are required to file a gift tax return. Keep track of gifts over \$13,000, as they will reduce the taxpayer's unified estate credit.

AMT – Alternative Minimum Tax is a parallel tax system that is used to ensure high-income earners are not escaping taxation. More and more taxpayers are facing this parallel tax system. AMT requires adjustments to the regular taxable income for tax preference items, and this eliminates favorable deductions. The maximum alternative tax rate is 28%, but tax is recalculated at a higher taxable income amount, causing a higher tax bill than expected. If you are subjected to AMT, it will not benefit you to make your 4th quarter estimated state income tax payment by December 31st. Making this payment in 2009 is usually a good tax tip, but if you are subjected to AMT, state taxes are a disallowed deduction and will not reduce your IRS tax liability.

Do you have Foreign Income Earnings? A \$10,000 civil penalty may be imposed on any person who fails to report foreign income. This penalty could increase to \$100,000 and jail time if it is a willful violation. You must let us know if you have any foreign income or money in offshore accounts.

Charges to your Credit Card – Deductible expenses, such as medical bills, charitable contributions, and business supply purchases, can be deductible if you charge them to your general use credit cards (Visa, Master Card, etc) before 12/31/09. This does not apply to specific store credit cards.

ALERT – IRS EMAIL SCAM – An email is circulating that makes a statement similar to this: “A refund will be issued to you from the IRS if you follow these instructions.” **This is a scam** – the IRS does not send emails to individuals. The IRS only sends correspondence via the U.S. Postal Service. **Never** open an email that claims to come from the IRS.

Electronic Filing – Obama has signed a new law this month that requires tax preparers that prepare more than 10 tax returns to file them electronically. All eligible tax returns prepared in this office will be filed electronically for 2009. It will be necessary for the taxpayer to review and approve his or her tax return before we transmit the data electronically to the IRS and the state. We must receive a signed Form 8879 (The IRS e-filing form) and payment for the tax preparation services from the taxpayer before we submit the electronic tax data. We cannot guarantee timely filing if Form 8879 is received in our offices after April 7, 2010. Please be sure to have all of your tax information to us by April 1, 2010 for timely processing. There will be a late processing fee for all information received by us after April 1, 2010.

Informational Data – An ‘Informational Data Sheet’ will be sent to all clients at the beginning of January to assist them in gathering their tax data. This will provide my office current contact information for our database and assist in preparing accurate tax returns. Please be sure to list the current phone numbers (work, home and cell) and valid e-mail addresses. Also, it is important that you list the current dependents, especially once they reach college age so we know whether to include them on your return.

Consent to Release Data – Due to new IRS rules regarding ethics and privacy, we will no longer be able to send copies of income tax returns to any third parties (mortgage companies or banks) without prior written consent from the taxpayer. We are happy to provide copies directly to you in person or via e-mail or fax, but we cannot send to anyone else on your behalf without written consent.

Financial Steps to Solvency - Many individuals are looking for ways to financial recovery. Here are my recommendations:

- #1 Cut Spending.
- #2 Track Expenses & Budget.
- #3 Increase income (if possible) by taking a second job.
- #4 Pay off high interest loans & negotiate lower interest rates on loans & credit cards.
- #5 Pay bills timely and make contact with creditors to set up a payment plan for overdue bills.

Privacy Statement

Federal law requires that once a year I inform you of our Privacy Policy. As you know, we collect certain personal information about you in order to prepare your tax returns. The information is either provided by you or obtained by our office with your permission. No personal information will ever be disclosed about you to anyone outside our firm except that which is already public by law or necessary to complete your work.

Should you become an inactive customer, we will continue to adhere to the policy regulations as written here. The information you give us about your personal or business records is reserved only for our employees who need to know in order to service your account. Procedural, physical, and electronic safeguards will be maintained in compliance with federal standards regarding your personal information. We are committed to retaining your confidence and want to assure you that any information you give us remains safe and confidential.