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Enhanced First-time Homebuyer Credit

In the Spring 2009 issue of this newsletter, we discussed the \$8,000 maximum tax credit that was available to first-time homebuyers through November 30, 2009. The credit is computed as 10 percent of the purchase price of the residence up to \$8,000. A first-time homebuyer is defined as one who has not owned a principal residence in the 36-month period preceding the purchase. In the case of a married couple, both must meet this test. A purchase cannot be from a related party, nor may the residence be acquired by gift or inheritance.



Recent legislation effective November 6, 2009, (“The Worker, Homeownership, and Business Assistance Act of 2009”) extended this refundable tax credit to purchases made on or before April 30, 2010. In addition, a new \$6,500 credit is available to existing homeowners who acquire a different principal residence. Thus, more taxpayers will be able to take advantage of this popular homebuyer credit. The discussion that follows identifies the more important features of this enhanced credit.

Binding Contract Exception. In addition to the April 30, 2010, extended purchase date, there is also a binding contract exception that effectively extends the deadline by two months. A first-time homebuyer qualifies for the credit if a binding contract is entered into on or before April 30, 2010, and the residence is actually purchased on or before June 30, 2010. There is a further one-year extension of these deadlines for overseas military and other service members.

Expanded Income Test. In addition to extending the credit, Congress has liberalized the income eligibility test. Previously, single filers lost eligibility as their adjusted gross income for the year of purchase moved from \$75,000 to \$95,000 (\$150,000 to \$170,000 for joint filers). Now, for purchases made after November 6, 2009, single filers qualify for the full credit if their adjusted gross income is under \$125,000, and joint filers are eligible until their income exceeds \$225,000. The credit for both categories of taxpayers phases out over a \$20,000 income range above these thresholds.

New Credit for Existing Homeowners. Existing homeowners who have owned and occupied the same principal residence for a five-consecutive-year period in the preceding eight years now also qualify for a tax credit on the purchase of a different residence (including new construction) after November 6, 2009. As with first-time homeowners, in the case of a married couple, both individuals must meet this five-year ownership and occupancy test. The credit is also 10 percent of the purchase price, but is limited to \$6,500.

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Enhanced First-time Homebuyer Credit continued from page 1

The income eligibility test, expiration date, and binding contract exception described above apply here also. As with the first time homebuyer credit, taxpayers may elect to claim the credit for a 2010 purchase as if the home were acquired on December 31, 2009. In that case, taxpayers claim the \$6,500 credit in their 2009 Form 1040 income tax return and accelerate the receipt of their tax refund, rather than waiting to file their 2010 tax return. If this election is made, the taxpayers' 2009 income is used to determine eligibility for the credit.

New Eligibility Restrictions. The homebuyer credit has several new limitations effective for purchases after November 6, 2009:

- A residence does not qualify if the purchase price exceeds \$800,000;
- The taxpayer must have reached the age of 18 on the date of purchase (or, if married, one of the spouses must be age 18);
- The purchaser cannot be eligible to be claimed as a dependent by another taxpayer for the year of the purchase;
- A copy of the executed settlement statement for the purchase of the home must be attached to the taxpayer's income tax return;
- A more expansive related party definition now applies to prohibit transactions such as a sale by a taxpayer to a daughter-in-law or son-in-law.

Three-year Recapture Rule. As before, the tax credit must be recaptured if the taxpayer sells or otherwise disposes of the residence within 36 months of the purchase. Limited exceptions apply in the case of the taxpayer's death, divorce, or destruction of the home, and a new exception is added for military or other service members who receive government relocation orders. But in general, taxpayers who earn this lucrative homebuyer credit will need to be mindful of the 36-month recapture rule: Sell the home 35 months after purchase and \$6,500 or \$8,000 is due to the government, but sell 37 months after purchase and no payback occurs.

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Business Loss Carryback Opportunities for Large and Small Businesses

In general, a business with a net operating loss (NOL) may apply that loss to the prior two tax years for offset of taxable income and recovery of tax refunds. For the 2008 tax year, Congress enacted a special elective three, four, or five-year NOL carryback, but this provision was available only to an eligible small business. A taxpayer qualified as an eligible small business if its average annual gross receipts for the three-year period ending with the loss year were \$15 million or less. As a result, larger businesses were not able to use this expanded carryback period for losses incurred in 2008.

Legislation enacted in 2009 now permits any business, small or large, to electively use the three, four, or five-year loss carryback for a NOL (net operating loss) for any tax year beginning in or ending in 2008 or 2009.

Legislation enacted in 2009 now permits any business, small or large, to electively use the three, four, or five-year loss carryback for a NOL for any tax year beginning in or ending in 2008 or 2009. The election is limited to one loss year only. Thus, for businesses operating on the calendar year, either 2008 or 2009 may be selected, while fiscal year businesses may use the loss for either the tax year ending in 2008, 2009, or 2010. However, a small business that satisfied the \$15 million gross receipts test and has used the prior provision for a 2008 loss may make an expanded NOL carryback election for a second year. The IRS recently issued guidance explaining how businesses may elect this enhanced NOL carryback option. **See Rev. Proc. 2009-52 for this guidance.**

For larger businesses that elect to use the new expanded carryback rule, a loss carryback to the fifth earliest year is restricted. In that case, only 50% of the taxable income in the fifth prior year may be offset by the loss carryback. Thus, larger businesses that now qualify for this election are advised to carefully analyze their prior income and tax rate levels in selecting the proper loss year in order to optimize their tax refunds. In some cases, it may be appropriate to defer the decision until the magnitude of any 2009 tax loss is determinable. We can assist in making this assessment.

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U.S. Savings Bond Redemptions

Many taxpayers may be holding matured, unredeemed savings bonds at home or in their safe-deposit boxes. If you are one of those taxpayers, you should cash them, as they are no longer earning interest and the redemption proceeds could be applied to other more profitable investments. Currently, the following savings bonds are no longer earning interest: all Series H bonds; many Series E bonds; some Series EE bonds; and some Series HH bonds. After June of this year, all Series E bonds will no longer earn interest. When redeeming the bonds, you will have to pay Federal income tax on the interest earned, but not state income tax. If your bond holdings and accrued interest amounts are substantial, you may want to spread the redemptions over several years to soften the tax impact. We can assist in developing a strategy that fits your specific situation.

Before cashing bonds that are still earning interest (*i.e.*, not matured), be sure to check when the interest accrues or you may lose as much as six months' interest. Older bonds tend to accrue interest every six months, while newer bonds accrue interest monthly. Also, in some cases, cashing a bond that has not been held for at least five years may result in a penalty of three months' interest.

Savings bonds may be redeemed through most banks and credit unions, or by mailing them to the U.S. Department of Treasury (after having your signature verified at a financial institution), or online. On the web, go to TreasuryDirect.gov, click on **Individuals, Research Center, Products in Depth**, and select the relevant **bond**. In the Tools section, you can calculate the amount of interest that has accrued on the bonds to be redeemed.

Before cashing bonds that are still earning interest (*i.e.*, not matured), be sure to check when the interest accrues or you may lose as much as six months' interest.

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Key 2010 Tax Amounts

As of January 1, 2010, the following rates and contribution limitations are in effect. The 2009 figures are provided for comparison and to aid in your income tax preparation for last year.

| | 2010 | 2009 |
|---|--|--|
| BUSINESS MILEAGE RATES | 50¢ per mile | 55¢ per mile |
| CHARITABLE MILEAGE RATES | 14¢ per mile | 14¢ per mile |
| MEDICAL/MOVING MILEAGE RATES | 16.5¢ per mile | 24¢ per mile |
| ANNUAL GIFT EXCLUSION | \$13,000 | \$13,000 |
| IRA DEDUCTIBLE CONTRIBUTION LIMIT | \$5,000; additional \$1,000 for those 50 and older | \$5,000; additional \$1,000 for those 50 and older |
| ROTH IRA NON-DEDUCTIBLE CONTRIBUTION LIMIT | \$5,000; additional \$1,000 for those 50 and older | \$5,000; additional \$1,000 for those 50 and older |
| 401(K), SEP, 403(B) TAX SHELTERED ANNUITY | \$16,500; additional \$5,500 for those 50 and older (adjusted for inflation) | \$16,500; additional \$5,500 for those 50 and older (adjusted for inflation) |

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COBRA Health Insurance Update

In the Spring 2009 newsletter, we described new legislation enacted in early 2009 that made it less expensive for recently terminated employees to retain their former employer's health insurance coverage. As originally enacted, the law provided for a 65% government subsidy of the employee's COBRA premiums for up to a 9-month period. In general, the former employee pays 35% of the COBRA premiums and the employer pays the balance, but the employer is later reimbursed through payroll tax credits. The law applied to employees who were involuntarily terminated on or after September 1, 2008, and on or before December 31, 2009, and who elected COBRA health care continuation coverage.



New legislation effective on December 19, 2009, (the "Department of Defense Appropriations Act of 2010") retroactively extended the COBRA subsidy an additional six months, increasing the maximum reimbursement period from nine months to 15 months. It also extended the COBRA subsidy to workers (and their family members) who lose their jobs during the first two months of 2010 (*i.e.*, through February 28, 2010). In addition, the new law revised the notice requirements for employers and their plan administrators.

Notice Requirements. First, plans subject to COBRA must provide a General Notice to all qualified beneficiaries (not just covered employees) who experienced an involuntary termination at any time from September 1, 2008, through February 28, 2010, and who have not yet been provided a notice to elect COBRA. Individuals who were terminated after December 19, 2009, must be provided an updated model General Notice within the normal timeframes for providing the COBRA election notice.

Second, plan administrators must also provide a notice (a model "Premium Assistance Extension Notice") to the following affected individuals who have already received a COBRA election notice that did not include information regarding the new law changes:

- ◆ Eligible individuals as of October 31, 2009, (who are not in a transition period) and individuals who were terminated on or after October 31, 2009, and lost health coverage (unless they already received the updated General Notice). The model notice must be provided to these individuals by February 17, 2010.
- ◆ Individuals who are in a "transition period" and lost assistance before Congress extended the subsidy coverage period to 15 months. The transition period begins at the end of the original nine-month subsidy coverage period, provided that period ended before December 19, 2009. Plan administrators have 60 days from the beginning of the transition period to provide information regarding the extended COBRA subsidy, informing of the right to make retroactive premium payments to maintain COBRA coverage. Notice must be provided to each eligible individual who was covered under COBRA immediately before the transition period but who did not timely pay any premium during that period, and to each eligible individual who paid 100% of the unsubsidized premium for the period.

Employee Action. An eligible individual currently receiving the COBRA subsidy need not do anything to qualify for the extended subsidy and will be automatically eligible for the enhanced benefits. However, eligible individuals who lost their subsidy must pay the reduced premium by the later of February 17, 2010, 30 days after notice of the extension is provided to the employee by the plan administrator, or the grace period that otherwise applies for premium payments under COBRA. Moreover, eligible individuals who paid the unsubsidized premium for any period of COBRA continuation coverage during the transition period should contact their employer or the plan administrator to seek reimbursement of the amount paid in excess of 35% of the premium cost, or arrange for a credit of the overpayment towards future months of coverage.

New DOL Guidance. On January 8, 2010, the Department of Labor issued a Fact Sheet and a set of FAQs that address the revised COBRA premium reduction rules. The DOL plans to issue in the near future revised model notices that plan administrators may use to notify eligible employees of the new benefits available to them. See <http://www.dol.gov/ebsa/cobra.html>.

Five-year Deferral of Business Debt Discharge Income



With the slump in the economy this past year, businesses have been renegotiating their outstanding debt obligations with their lenders. In some instances, lenders have agreed to eliminate some business debt. This can take various forms such as a cancellation of a note, a refinancing of the existing debt, or a transfer of the debt to a related entity. Where this occurs, a business will have discharge of debt income to the extent that some or all of the debt is forgiven. Debt discharge income is generally includible in business gross income and will be taxable, unless an exception in the tax law allows exclusion from income. The tax law currently provides a number of exclusions for debt discharge income for businesses and individuals (*e.g.*, the discharge occurs in bankruptcy or when the taxpayer is insolvent; the debt is qualified farm indebtedness, qualified real property business indebtedness, or qualified principal residence indebtedness). If a taxpayer is entitled to exclude the debt forgiveness from income, it generally must reduce certain tax attributes, such as loss carryovers, credit

carryovers, or basis in property, to the extent of the debt discharge income.

Congress, being aware of the many debt relief situations, enacted a new law to provide further relief to taxpayers that incur debt discharge income in connection with business debt in 2009 or 2010. Where that occurs, the taxpayer may elect to defer the recognition of the income until 2014, at which point the income is reported ratably over a 5-year period from 2014 through 2018. The following conditions must be satisfied:

- ◆ The debt must be issued by a C corporation or any other person (including an S corporation) in connection with its trade or business.
- ◆ The debt must be reacquired by the debtor itself or a related person.
- ◆ The reacquisition can occur in many formats (*e.g.*, a partial settlement for cash; exchange of debt instruments; exchange of debt for stock or a partnership interest; contribution of debt to capital; or forgiveness of debt by the lender).
- ◆ The taxpayer makes an irrevocable election on a per debt instrument basis in its income tax return for the year in which the debt relief occurs, clearly identifying the debt instrument and the amount of the debt discharge income being deferred.
- ◆ For a partnership, S corporation, or other pass-through entity, the election is to be made at the entity level.
- ◆ The deferred income will be accelerated if the taxpayer “departs” before all of the income has been reported (*e.g.*, upon the taxpayer’s death, the liquidation or sale of substantially all of the business’ assets, including in bankruptcy, the cessation of the business, the sale or exchange or redemption of an interest in a partnership, S corporation, or other pass-through entity by an owner).

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Taxpayers with business debt discharge income in 2009 or 2010 may qualify for both an existing debt relief provision as well as this new 5-year deferral. In selecting the best relief tool, some of the factors to be considered are the taxpayer’s expected tax bracket in the deferral years; the existence of expiring net operating losses that could offset the debt discharge income; the possibility of tax losses in later years; future plans to sell or liquidate the business which could accelerate the deferred income; the timing impact of tax attribute reduction under the other debt exclusion rules; etc. If you expect to have debt discharge income this year or next, we can help you with this kind of analysis and present you with the best tax options for your business. Please contact us at 330-453-7633 or visit us at www.hallkistler.com.



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HK Notes

- ◆ Congratulations to staff accountant **Mickey Stachel, MT, CPA** who passed the Certified Public Accountants Exam and earned his CPA designation and to senior accountant, **Anthony Schuster, CPA, CFE** who passed the Association of Certified Fraud Examiners test and now holds the CFE designation.
- ◆ Supervisors **Katie Fuetter, CPA** and **Scott Bonvechio** presented seminars at the January meeting of the Institute of Management Accountants (IMA) at Skyland Pines. Katie, the keynote for the evening, presented the 2009 Tax Law Changes and Scott presented a pre-session on the U.S. FASB (GAAP) and its convergence with the International Financial Reporting Standards (IFRS).

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