2009 Workbook

WHAT'S NEW SUPPLEMENT

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CORRECTIONS TO 2009 FEDERAL TAX WORKBOOK

Page	Correction or addition
6	Change the amount in No. 1 at the bottom of the page from $2,000 to $10,000 and the amount in No. 2 from $100,000 to $400,000.
51	In the second paragraph on the page, change "Form 8832" to "Form **8332**."
53	In the first sentence under the heading "New Tie-Breaker Rule," change the words "may be" to "is." In the following sentence, add the words "if the parties cannot agree" after "is mandatory."
164	Change the last full sentence before the table at the bottom of the page to "Richard's carryover basis is $5,160 ($12,363 – $7,203)." Strike the text and the table that follow this sentence on the page.
165	Change the next to last sentence in the paragraph preceding the table to "Richard's carryover basis is $4,952 ($9,443 – (195 × $23.03)).
171	In **Example 19,** the fourth sentence should read: "The personal residence, except to the extent of business use, is not taken into consideration for this purpose."
229	In the sentence that precedes the chart, the words "each individual in" should be inserted before the words "each group."
290	At the top of the page, change the "and" at the end of the first bullet point to "or."
316	In the sixth bullet point under "Estate Tax Provisions," add the following sentence at the end: "The 8-year testing period also may end at the time the taxpayer becomes disabled or begins receiving social security retirement benefits."
316	After the sixth bullet point, add a **Note** box that reads: "A decedent, prior to death, is permitted to rent qualified property to a family member on a net cash basis. Additionally, a decedent, prior to death, may lease real property to a separate business. This separate business must be closely held with respect to the decedent, with no more than 15 family members owning and operating the business. Such lease periods count toward the decedent's pre-death qualified use period."
317	Footnote 38 should read: "See IRC §267(b); the 50% ownership percentage mentioned in §267(b)(2) drops to 10%. See Rev. Proc. 2008-59."
354	The citation in Footnote 51 should read: "Treas. Reg. §1.401(a)(9)-5, A-5(a)(2)."
372	In the second note box on the page, insert the words "election-year" before "NOL to offset a prior year's income."
374	In the table at the bottom of the page, change the code section for the gain recognized from "§356" to "§351."
412	In **Example 12,** all references to "Ted" should be changed to "Sam."
417	In the last sentence on the page, change "2008" to "2009."
438	In the last sentence before the **Notebox,** strike the words following "applies to any" and replace with: "dwelling unit located in the United States and used as a residence by the taxpayer."

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439 Under the bullet point “Biomass stoves,” add a **Notebox** that reads: “The term ‘biomass’ is defined in IRC §45K(c)(3) as any organic material other than oil, natural gas, coal, or any product thereof. The term thus includes corn, pellet, and wood-burning stoves. These stoves must have a thermal efficiency rating of at least 75% to qualify for the energy credit. For more information, see **www.energystar.gov.”**

522 Under “Issue 3 — Year of Deduction,” change the beginning of the last sentence of the second paragraph to “There must **not** be… ”

IL-3 In No. 1 near the bottom of the page, after the words “was eliminated” add “since this credit is now reported on the new schedule.”

IL-4 The changes specified under the heading “Partnership Replacement Tax Change” have been repealed by the passage of Public Act 96-0835, which was signed by the governor on December 16 and is effective immediately.

IL-5 Delete the **Observation** box in the middle of the page, and replace it with a **Notebox** that reads: “H.B. 2239, which **repeals** the partnership replacement tax changes described in this section, was passed by the Illinois House and Senate in late October. The bill is currently awaiting the governor’s signature.”

IL-32 In the first sentence under the heading “Homestead Improvement Exemption,” replace the words following “…is available for” with the following: “new improvements to existing structures on homestead property or the rebuilding of residential structures following a catastrophic event.”

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WORKER, HOMEOWNERSHIP, AND BUSINESS ASSISTANCE ACT OF 2009

On November 6, 2009, President Obama signed the Worker, Homeownership, and Business Assistance Act of 2009 (WHBAA) into law. The main provisions of this act are analyzed below.

FIRST-TIME HOMEBUYER CREDIT

Old Law. In 2008, a refundable first-time homebuyer credit was introduced for individuals purchasing a home between April 9, 2008, and June 30, 2009. The credit was the lesser of $7,500 or 10% of the purchase price of a principal residence. A first-time homebuyer is defined as an individual (and, if married, the individual's spouse) who has not owned a principal residence in the United States for three years preceding the current purchase date.

Recapture of this credit is without interest and begins the second year after the principal residence is purchased. The taxpayer increases the federal tax liability by 6.66% of the credit amount each year during the recapture period. The recapture period is defined as the 15 taxable years that begin the second year following the year in which the principal residence for which the credit was allowable was purchased. Recapture also occurs if the residence is sold or ceases to be used as a principal residence.

> **Note.** For more information on this credit, see pages 428–429 in the 2008 *University of Illinois Federal Tax Workbook.*

For 2009, the first-time homebuyer credit was modified and expanded. It was increased to the lesser of $8,000 or 10% of the purchase price and applies to home purchases on or after January 1, 2009, and before December 1, 2009. For married persons filing separately, the maximum credit is $4,000.

There is no recapture on the 2009 homebuyer credit if the taxpayer uses the home as his or his spouse's principal residence for at least 36 months, starting on the date of purchase. If the home ceases to be used as a principal residence during this initial 36-month period, the credit must be recaptured by including the recapture amount as additional tax on the return for the year during which the home ceases to be used as a principal residence.

> **Note.** See pages 421–426 in the 2009 *University of Illinois Federal Tax Workbook* for more information on this refundable credit.

New Law. The WHBAA extends the credit on purchases of principal residences to April 30, 2010; however, if a binding contract is in place by that date, homebuyers have until June 30, 2010 to close on the purchase. The credit for first-time homebuyers (those who have not owned a home in the United States during the previous three years) remains at 10% of the purchase price, with a maximum of $8,000. Married taxpayers filing separately have a maximum credit of $4,000 available.

For an individual (and the individual's spouse, if married) on qualified official extended duty outside the United States for at least 90 days during the period between December 31, 2008 and May 1, 2010, the expiration date of the first-time homebuyer credit is extended an additional year. In such case, the relevant expiration date is April 30, 2011, or June 30, 2011, if there is a binding written contract in effect by April 30, 2011 to close on a principal residence by June 30, 2011.

Credit for Long-Time Homeowners

The credit is expanded under the WHBAA to include homeowners who have owned the same principal residence for any five consecutive years during the 8-year period ending on the date of purchase of a subsequent principal residence. These long-time homeowners are treated as first-time homebuyers. However, the credit for these taxpayers is 10% of the purchase price, with a **maximum of $6,500.** Married taxpayers filing separately are limited to a maximum credit of $3,250. This provision is effective only for homes purchased **after** November 6, 2009 and before April 30, 2010 (or June 30, 2010, if a binding written contract is in place by April 30, 2010).

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Example 1. Justin is a single taxpayer who has lived in the same principal residence for the past 10 years. He purchases a new home in February 2011 for $250,000. Justin qualifies for a $6,500 homebuyer credit.

Example 2. Franklin and Jessica jointly owned a principal residence where they lived for six years prior to their divorce in October 2009. Jessica received the home as part of the property settlement. Franklin buys a new principal residence on April 1, 2011 for $190,000. He qualifies for a $6,500 homebuyer credit because he owned the prior principal residence for at least five of the eight years ending on April 1, 2011.

Income Limitations

Old Law. For both previous versions of the first-time homebuyer credit, the credit was phased out for single taxpayers with modified adjusted gross incomes (MAGI) between $75,000 and $95,000 and for married taxpayers filing joint returns with MAGIs between $150,000 and $170,000.

New Law. The new act raises the phaseout range to $125,000–$145,000 for single taxpayers and $225,000–$245,000 for married couples filing jointly. The new phaseout ranges are effective for homes purchased after November 6, 2009 and before April 30, 2010 (or June 30, 2010, if a binding written contract is in place by April 30, 2010).

Purchase Price Limitation

Old Law. There was no restriction on the maximum purchase price of a qualifying principal residence.

New Law. The WHBAA imposes a ceiling on the purchase price of a principal residence. Homes that cost more than $800,000 are not eligible for the homebuyer credit. This ceiling applies to homes purchased after November 6, 2009 and before April 30, 2010 (or June 30, 2010, if a binding written contract is in place by April 30, 2010).

Election to Claim Credit on Prior Year Return

Old Law. If the principal residence was purchased in 2009, the taxpayer can elect to treat the purchase as occurring on December 31, 2008.

New Law. Taxpayers may elect to treat the purchase of a home purchased in 2009 or 2010 as made on December 31 of the calendar year preceding the actual purchase date of the principal residence. This allows taxpayers to gain access to the refundable credit more quickly by claiming the credit on the previous year's tax return. The election is made on Form 5405, *First-Time Homebuyer Credit and Repayment of the Credit.*[1]

Example 3. Lynette is a first-time homebuyer. She closed on the purchase of a $150,000 home on March 15, 2010. Lynette may elect to claim the $8,000 first-time homebuyer credit on her 2009 tax return.

For some taxpayers, it may make more financial sense to wait and claim the homebuyer credit when they file their tax returns for the year of the home purchase rather than claiming it on the previous year's tax return. For example, some taxpayers may qualify for a higher credit on their 2010 tax returns, including people who have less income in 2010 than 2009 because of factors such as a job loss or a drop in investment income.

Example 4. Tyrell is a single taxpayer who purchases his first home for $300,000 on April 16, 2010. His MAGI for 2009 is $130,000, but he estimates that his MAGI for 2010 will be $100,000. If he elects to claim the credit on his 2009 tax return, he will be eligible only for a $6,000 first-time homebuyer credit because of the income phaseout limitations. However, if Tyrell's estimate of his 2010 income is reasonably accurate, he will be eligible to claim the maximum $8,000 credit on his 2010 tax return.

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1. According to the IRS website, Form 5405 will be revised in December 2009. The December 2009 revision must be used to claim the first-time homebuyer credit for homes purchased after November 6, 2009.

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Recapture Provisions

There is no repayment provision for principal residences purchased in 2009 or 2010 as long as the taxpayer uses the home as a principal residence for at least 36 months from the date of purchase. If the home ceases to be the taxpayer's principal residence within the initial 36-month period, the taxpayer must repay the credit by including the recapture amount as additional tax on the return for the year during which the home ceases to be used as a principal residence. Following are the exceptions to the recapture rule:

1. **The taxpayer sells the home to an unrelated party.** Recapture is limited to the amount of any profit received on the sale of the principal residence to an unrelated party. The gain is calculated by reducing the adjusted basis of the home by the amount of the credit.

Example 5. Scott purchases a principal residence on May 17, 2010, for $210,000 and receives an $8,000 first-time homebuyer credit. On November 8, 2010, he sells his home for $205,000 so that he can pursue his dream of becoming a Broadway actor. This results in a $3,000 ($205,000 – ($210,000 – $8,000)) profit on the sale. Consequently, Scott must recapture $3,000 of the first-time homebuyer credit (the lesser of the gain on the sale or the $8,000 first-time homebuyer credit).

Example 6. The facts are the same as **Example 5,** except Scott sold the home for $200,000. This results in a $2,000 loss ($200,000 – ($210,000 – $8,000)). Scott has no credit recapture.

2. **The home is destroyed, condemned, disposed of under threat of condemnation, or there is an involuntary or compulsory conversion, and the taxpayer acquires a new principal residence within two years of the qualifying event.** No repayment is required.

3. **As part of a divorce settlement, the home is transferred to a spouse or former spouse.** The spouse who receives the home is responsible for repaying the credit if the home is sold or ceases to be used as a principal residence before the end of the requisite 36-month period.

Example 7. On December 3, 2009, Rena and Caden purchase a principal residence and receive an $8,000 credit. In November 2010, the couple divorce, and Rena receives the home as part of the property settlement. In December 2011, Rena remarries and moves out of state with her new husband. Because the home purchased in 2009 is not Rena's principal residence for 36 months, she must recapture the entire $8,000 credit. However, if she sells the house to an unrelated party, the rules under number 1 above apply.

4. **The taxpayer dies.** Repayment of the credit is not required. However, if the deceased taxpayer claimed the credit on a joint return, the surviving spouse must repay half the credit if the spouse ceases to use the home as a principal residence before the end of the 36-month period.

Example 8. Ashlee and Jeremiah purchase a principal residence on December 1, 2009, and receive an $8,000 credit after filing their 2009 joint return. Ashlee dies in September 2010. Because of the painful memories associated with the house, Jeremiah sells the home in March 2011 and realizes a $10,000 profit. He is liable for $4,000 of credit recapture.

For members of the uniformed services, the intelligence community, or the Foreign Service of the United States, the recapture provisions are waived if the disposition of the principal residence occurs in connection with government orders for qualified official extended duty received by the individual or the individual's spouse. Qualified official extended duty is defined as any period of extended duty while serving at a place of duty at least 50 miles away from the taxpayer's principal residence or compelled residence in government-furnished quarters.

Other Restrictions

Age. Taxpayers younger than age 18 do not qualify for the first-time homeowner credit. A married taxpayer who is younger than age 18 qualifies for the credit if the taxpayer's spouse has attained age 18. This provision applies to purchases of homes after November 6, 2009.

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Dependency. Taxpayers who may be claimed as dependents by another taxpayer are not eligible for the credit, whether or not they are actually claimed. This restriction is effective for principal residences purchased after November 6, 2009.

Related Party Purchase. A purchase of property from a party related to the taxpayer or the taxpayer's spouse does not qualify for the credit. Related parties in this context include brothers and sisters, ancestors, and lineal descendants.[2]

Settlement Statement Required. In order to qualify for the credit, a taxpayer claiming the credit must attach a copy of the settlement statement for the purchase of the residence to the tax return. This provision applies to principal residences purchased after November 6, 2009.

Coordination with D.C. Homebuyer Credit. Taxpayers purchasing a home after December 31, 2008 cannot claim the District of Columbia first-time homebuyer credit if the national first-time homebuyer credit is available to the taxpayer or the taxpayer's spouse.

IRS's Mathematical Error Authority

The WHBAA adds a provision to IRC §6213 that gives the IRS expanded mathematical error authority. IRC §6213(g)(2)(O)-(P) specifically addresses the homebuyer credit and allows the IRS to assess additional tax without issuing a deficiency notice in the case of:

- Omission of any additional tax required by the recapture provisions,
- Information indicating that the person claiming the credit does not meet the minimum age requirement,
- Information provided to the IRS by the taxpayer on an income tax return for at least one of the two years preceding the credit that indicates inconsistency with the requirements of the credit, or
- Failure to attach a properly executed settlement statement to the tax return.

The expanded mathematical error authority applies to returns for taxable years ending on or after April 9, 2008.

> **Note.** The Joint Committee on Taxation (JCT) estimates that the extension and modification of the first-time homebuyer credit will cost the federal government $12.7 billion in fiscal years 2010-2011.

NOL CARRYBACK PERIOD EXTENDED

Old Law. Under the provisions of the American Recovery and Reinvestment Act of 2009 (ARRA), eligible small businesses (ESB) can elect a 3-, 4-, or 5-year carryback period for an NOL arising from a tax year beginning or ending in 2008, instead of the standard 2-year carryback. An ESB for purposes of the increased carryback period is one whose 3-year average gross receipts ending with the tax year in which the loss arose do not exceed $15 million. When applying the average gross-receipts test, the receipts of all entities under common control must be included in the calculation. An ESB can be a sole proprietorship, a partnership, or a corporation.

5-year NOL Carryback Available to All Businesses

The WHBAA allows **businesses of any size** (with the exception noted below) up to a 5-year carryback period for NOLs arising in tax years ending after December 31, 2007, and beginning before January 1, 2010. This election is generally available for only one taxable year. However, those ESBs that made a timely election under ARRA to carry back 2008 NOLs for three, four, or five years may also make the election for 2009; thus, these businesses may carry back **both** 2008 and 2009 NOLs for up to five years.

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2. IRC §267.

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Limitation. Under the WHBAA, businesses are limited in the amount of the NOL that can be carried back to the fifth preceding taxable year. This amount cannot exceed 50% of the taxable income for the fifth carryback year. However, the NOL remaining after applying the 50% limitation in the fifth carryback year is fully available to offset taxable income in years subsequent to the fifth carryback year.

> **Example 9.** Nebulous Concrete Co. has taxable income of $10 million for every year from 2004 through 2008. In 2009, there is a management change at Nebulous, which results in a lack of focus on the company's primary business purpose. Consequently, Nebulous incurs a $45 million net operating loss for the year. The company elects to carry back the 2009 NOL for the maximum 5-year period. The amount of the NOL that can be carried back to 2004 is $5 million (half of the taxable income for 2004). Nebulous can use the remaining $40 million NOL carryback to fully offset the taxable income for 2005, 2006, 2007, and 2008.

The 50% limitation for the fifth preceding taxable year does not apply to ESBs that elected to carry back 2008 NOLs under the ARRA, even if such election is made after the date of enactment of the WHBAA. However, the limitation does apply to 2009 NOLs carried back by ESBs.

TARP Recipients Not Eligible. Taxpayers that received benefits under the Emergency Economic Stabilization Act of 2008 (TARP recipients) are not eligible for an extension of the NOL carryback period.

AMT Limitation Suspended

Under previous rules, a taxpayer's NOL deduction could not reduce the taxpayer's alternative minimum taxable income (AMTI) by more than 90% of the AMTI.[3] The WHBAA suspends this 90% limitation on NOL deductions for which an extended carryback period is elected.

Election

In order to apply the extended carryback provision, an election must be made by the 2009 tax return's due date (including extensions). This election is irrevocable.

Rev. Proc. 2009-52 provides guidance on the proper manner of electing the 3-, 4-, or 5-year NOL carryback period. Under this revenue procedure, there are two methods for electing the carryback:

Method 1. For the year in which the NOL arises, a statement is attached to the timely-filed return, **including** extensions. If the taxpayer has already filed its income tax return for the year in which the NOL arises, it may make the election by attaching a statement to an amended return for the taxable year of the applicable NOL. The statement must stipulate that the taxpayer is electing to apply IRC §172(b)(1)(H) or §810(b)(4) under Rev. Proc. 2009-52, and that the taxpayer is not a TARP recipient nor an affiliate of a TARP recipient. The statement must also specify the length of the NOL carryback period elected by the taxpayer (three, four, or five years).

The taxpayer's original or amended income tax return for the taxable year of the NOL must be filed with the election statement on or before the due date (including extensions) for the 2009 tax return.

If the taxpayer completes a claim for tentative carryback adjustment (Form 1045, *Application for Tentative Refund*, or Form 1139, *Corporation Application for Tentative Refund*), a copy of the election statement must be attached. The due date for filing a claim on Form 1045 or 1139 for a taxpayer making the §172(b)(1)(H) election is extended to the due date, including extensions, for filing the 2009 tax return.

Method 2. If the return was filed without an election to apply the new law and the return did not include an election to forgo the carryback period, the IRS permits the taxpayer to make the election by filing one of the appropriate forms applying the NOL carryback period chosen by the taxpayer. The election statement described above under **Method** 1 must be attached to the form. This form must be filed within **six months** of the due date of the return **excluding** extensions.

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3. IRC §56(d).

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For the following types of taxpayers, the appropriate forms are:

- **For corporations:** Form 1139, *Corporation Application for Tentative Refund*, or Form 1120X, *Amended U.S. Corporation Income Tax Return*, for the earliest tax year of the carryback period.
- **For individuals:** Form 1045, *Application for Tentative Refund*, or Form 1040X, *Amended U.S. Individual Income Tax Return*, for the earliest tax year of the carryback period.
- **For estates or trusts:** Form 1045, or an amended Form 1041, *U.S. Income Tax Return for Estates and Trusts*, for the earliest tax year of the carryback period.
- **For tax exempt organizations with unrelated business income:** Form 1139, or an amended Form 990-T, *Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e))*, for the earliest tax year of the carryback period.

Procedure if Previous Carryback Application Filed. A taxpayer that previously filed an amended return or application for a tentative carryback adjustment prior to enactment of the WHBAA may make the §172(b)(1)(H) election by following the procedures described above under **Method 1** or **2.** The taxpayer's election statement must specify that the election amends a previous carryback application or claim. This procedure does not apply to ESBs that made a carryback election under ARRA.

Revocation of Election to Waive Carryback Period. A taxpayer that previously elected under IRC §§172(b)(3) or 810(b)(3) to forgo the carryback period for an applicable NOL for a taxable year ending before November 6, 2009, may revoke that election and make the election under §172(b)(1)(H). This revocation will also apply to a carryback of any alternative tax NOL for the same taxable year. The taxpayer should attach an election statement to the appropriate tax return (listed above) that states that the taxpayer is revoking an NOL carryback waiver and electing to apply §§172(b)(1)(H) or 810(b)(4) under Rev. Proc. 2009-52 and that the taxpayer is not a TARP recipient nor an affiliate of a TARP recipient. The statement must also specify the length of the NOL carryback period the taxpayer elects. The revocation must be made by the extended due date of the taxpayer's 2009 tax return.

> **Note.** The JCT estimates that the expansion of the NOL carryback period will cost the federal government $33.2 billion in fiscal year 2010, leveling off to $10.4 billion over a 10-year time frame.

MODIFICATION OF FAILURE-TO-FILE PENALTY

Old Law. For returns required to be filed after December 31, 2008, the failure-to-file penalty for S corporations and partnerships is $89 multiplied by the number of shareholders or partners for each month (or fraction of a month) that the failure continues, up to a maximum of 12 months.

New Law. Under the WHBAA, the failure-to-file penalty is increased to $195 per month (or fraction thereof) for each shareholder or partner, up to a maximum of 12 months. This provision applies to S corporation and partnership returns for taxable years beginning after December 31, 2009.

> **Note.** The JCT estimates that the increase in the failure-to-file penalty on S corporations and partnerships will raise $1.2 billion over 10 years.

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ELECTRONIC FILING REQUIREMENT

Old Law. For tax years ending on or after December 31, 2006, corporations and tax-exempt organizations with assets of at least $10 million and that file 250 or more returns during a calendar year are required to electronically file their Forms 1120/1120S income tax returns and Form 990 information returns. Income tax, information, excise tax, and employment tax returns are counted in determining whether the 250-return threshold has been met. Additionally, private foundations and charitable trusts, regardless of asset size, are required to electronically file their Forms 990-PF returns for tax years ending on or after December 31, 2006 if they file at least 250 returns in a calendar year.

New Law. The WHBAA maintains the above electronic-filing requirement for corporations, tax-exempt organizations, private foundations, and charitable trusts. It also includes a provision that requires electronic filing for the vast majority of tax return preparers for tax returns filed after December 31, 2010. Only tax return preparers who prepare, or can reasonably expect to prepare, fewer than 10 individual income tax returns in a calendar year are exempted from the electronic-filing requirement. The term "individual income tax returns" in this context includes estate and trust returns.

> **Note.** It is not yet clear how the electronic-filing requirement will be monitored. Additionally, there is no mention in the WHBAA of a penalty for tax return preparers who do not comply with the new requirement.

FUTA SURTAX EXTENDED

The federal unemployment tax act (FUTA) surtax of .2% is extended through June 30, 2011. The total FUTA tax on employers remains at 6.2% of taxable wages, with a credit of up to 5.4% of taxable wages for amounts paid into state unemployment funds.

> **Note.** The WHBAA also extends unemployment insurance benefits for jobless workers by up to 14 additional weeks (and by 20 weeks for workers in states with unemployment rates over 8.5%). The extension of the FUTA surtax is expected to fully offset the additional unemployment benefits.

2014 ESTIMATED TAXES FOR LARGE CORPORATIONS INCREASED

For corporations with assets of at least $1 billion, estimated tax payments due in July, August, or September 2014 are increased to 100.25% of the payment otherwise due. The next required estimated tax payment is reduced accordingly.

MILITARY SPOUSES RESIDENCY RELIEF ACT

On November 11, 2009, the president signed the Military Spouses Residency Relief Act. The purpose of the act is to prevent a person from losing domicile or residence in a state because they accompany a spouse to a different state in compliance with military or naval orders. The act covers both voting rights and state income taxation.

> **Example 10.** Harry and Martha currently live Texas, a state with no state income tax. Harry is a member of the armed forces and is transferred to Ohio, a state with an income tax. Martha chooses to follow Harry to Ohio and lives there while Harry is serving in the military. Martha and Harry's income level requires them to file a federal income tax return. While they would normally be required to file an Ohio state income tax return, the Military Spouses Residency Relief Act deems them to be residents of Texas.
>
> The act also allows them to continue to vote in Texas state and local elections rather than Ohio even though they are absent from Texas.

This legislation is effective for any tax year that includes the date of enactment. For calendar-year taxpayers, this will include all 2009 income.

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DEPARTMENT OF DEFENSE APPROPRIATIONS ACT OF 2010

On December 19, 2009, President Obama signed the Department of Defense Appropriations Act of 2010 (DODAA) into law. This act extends the COBRA premium subsidy that was enacted under the American Recovery and Reinvestment Act.

COBRA CONTINUATION COVERAGE

Old Law. Eligible individuals can elect COBRA continuation coverage for health insurance by paying 35% of the premiums. A premium subsidy is provided for the remaining 65%. The subsidy was limited to no more than nine months per individual and was provided to individuals subject to involuntary terminations on or after September 1, 2008, and before January 1, 2010. The subsidy applies to terminated employees and their family members who are qualified beneficiaries. The amount of the premium subsidy is excluded from gross income of eligible individuals.

> **Note.** For more information on the COBRA continuation rules, which were applicable before the enactment of the DODAA, see Chapter 11 in the 2009 *University of Illinois Federal Tax Workbook.*

New Law. The DODAA lengthens the maximum subsidy period from nine to 15 months and extends the eligibility period to include individuals subject to involuntary terminations from September 1, 2008 through February 28, 2010.

Under the DODAA, eligible individuals may elect to pay premiums retroactively and maintain COBRA coverage. Individuals are treated as having timely paid the amount required for COBRA continuation if:

1. The individual was covered under the COBRA continuation rules for the period during which the premium applies immediately preceding December 19, 2009 (the transition period), and
2. The individual pays the amount of the COBRA premium by the later of February 17, 2010 (60 days after the enactment of the DODAA) or 30 days after the insurance plan administrator notifies the individual of the DODAA provisions.

Eligible individuals who do not timely pay the amount required for COBRA continuation coverage must be notified by the group health plan administrator (or other applicable entity) within 60 days of the transition period of the changes made by the DODAA. The information provided in the notice must include the ability to make retroactive payments for the transition period in order to maintain COBRA coverage.

The COBRA subsidy phases out for individuals with modified adjusted gross income (MAGI) between $125,000 and $145,000 ($250,000–$290,000 for MFJ taxpayers). If an individual receives a COBRA subsidy and has MAGI exceeding $145,000 ($290,000 if MFJ), the full amount of the subsidy must be repaid as additional tax.

ILLINOIS PUBLIC ACT 96-0835

Old Law. Illinois Governor Patrick Quinn signed the Emergency Budget Implementation Act of Fiscal Year 2010 on July 15, 2009. One of the provisions in the act modified the definition of partnership taxable income by **terminating** the deduction for the greater of personal service income or a reasonable allowance for partner's compensation. The act also ended the requirement to add back guaranteed payments to partners, which are federally deductible, into Illinois taxable income. These changes were to go into effect for taxable years ending on or after December 31, 2009.

> **Note.** For more information on the modifications to partnership replacement tax, see pages IL4-5 in the 2009 *University of Illinois Federal Tax Workbook.*

New Law. Illinois Public Act 96-0835 was signed by Governor Quinn on December 16, 2009. This act restores the deduction allowed for the greater of personal service income of a partnership or a reasonable allowance for partners' compensation. It also restores the requirement to add back guaranteed payments to partners into Illinois taxable income. These changes are effective December 16, 2009.

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MISCELLANEOUS

2010 IRS REFUND INFORMATION FOR E-FILERS

The following chart is from IRS Publication 2043 and shows the projected date that direct deposit refunds will be sent and paper checks mailed, based on the date an e-filed tax return is accepted by the IRS. However, the IRS does not guarantee that refunds will be processed on the specified dates.

Transmitted and accepted (by 11:00 am) between…	Direct Deposit Sent*	Paper Check Mailed*
Jan 15 and Jan 21, 2010	Jan 29, 2010	Feb 5, 2010
Jan 21 and Jan 28, 2010	Feb 5, 2010	Feb 12, 2010
Jan 28 and Feb 4, 2010	Feb 12, 2010	Feb 19, 2010
Feb 4 and Feb 11, 2010	Feb 19, 2010	Feb 26, 2010
Feb 11 and Feb 18, 2010	Feb 26, 2010	Mar 5, 2010
Feb 18 and Feb 25, 2010	Mar 5, 2010	Mar 12, 2010
Feb 25 and Mar 4, 2010	Mar 12, 2010	Mar 19, 2010
Mar 4 and Mar 11, 2010	Mar 19, 2010	Mar 26, 2010
Mar 11 and Mar 18, 2010	Mar 26, 2010	Apr 2, 2010
Mar 18 and Mar 25, 2010	Apr 2, 2010	Apr 9, 2010
Mar 25 and Apr 1, 2010	Apr 9, 2010	Apr 16, 2010
Apr 1 and Apr 8, 2010	Apr 16, 2010	Apr 23, 2010
Apr 8 and Apr 15, 2010	Apr 23, 2010	Apr 30, 2010
Apr 15 and Apr 22, 2010	Apr 30, 2010	May 7, 2010
Apr 22 and Apr 29, 2010	May 7, 2010	May 14, 2010
Apr 29 and May 6, 2010	May 14, 2010	May 21, 2010
May 6 and May 13, 2010	May 21, 2010	May 28, 2010
May 13 and May 20, 2010	May 28, 2010	May 28, 2010
May 20 and May 27, 2010	Jun 4, 2010	Jun 11, 2010
May 27 and Jun 3, 2010	Jun 11, 2010	Jun 18, 2010
Jun 3 and Jun 10, 2010	Jun 18, 2010	Jun 25, 2010
Jun 10 and Jun 17, 2010	Jun 25, 2010	Jul 2, 2010
Jun 17 and Jun 24, 2010	Jul 2, 2010	Jul 9, 2010
Jun 24 and Jul 1, 2010	Jul 9, 2010	Jul 16, 2010
Jul 1 and Jul 8, 2010	Jul 16, 2010	Jul 23, 2010
Jul 8 and Jul 15, 2010	Jul 23, 2010	Jul 30, 2010
Jul 15 and Jul 22, 2010	Jul 30, 2010	Aug 6, 2010
Jul 22 and Jul 29, 2010	Aug 6, 2010	Aug 13, 2010
Jul 29 and Aug 5, 2010	Aug 13, 2010	Aug 20, 2010
Aug 5 and Aug 12, 2010	Aug 20, 2010	Aug 27, 2010
Aug 12 and Aug 19, 2010	Aug 27, 2010	Sep 3, 2010
Aug 19 and Aug 26, 2010	Sep 3, 2010	Sep 10, 2010
Aug 26 and Sep 2, 2010	Sep 10, 2010	Sep 17, 2010
Sep 2 and Sep 9, 2010	Sep 17, 2010	Sep 24, 2010
Sep 9 and Sep 16, 2010	Sep 24, 2010	Oct 1, 2010
Sep 16 and Sep 23, 2010	Oct 1, 2010	Oct 8, 2010
Sep 23 and Sep 30, 2010	Oct 8, 2010	Oct 15, 2010
Sep 30 and Oct 7, 2010	Oct 15, 2010	Oct 22, 2010
Oct 7 and Oct 14, 2010	Oct 22, 2010	Oct 29, 2010
Oct 14 and Oct 21, 2010	Oct 29, 2010	Nov 5, 2010

WAIVER OF UNDERPAYMENT PENALTIES

The IRS modified the payroll withholding tables in the spring of 2009 to reflect the making work pay credit, under which most taxpayers with earned income are allowed a refundable credit up to a maximum of $400 per individual ($800 for MFJ couples).

Many taxpayers (particularly married couples and individuals receiving pensions) may find that their 2009 withholding is insufficient because the new tax tables gave them a higher credit than they were entitled to. Accordingly, the IRS will waive the underpayment penalty if it determines that the penalty is due to adjustments from the making work pay credit.

To request the penalty waiver, the taxpayer must file Form 2210, *Underpayment of Estimated Tax by Individuals, Estates, and Trusts.*

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RULINGS AND CASES

BANKRUPTCY AND DISCHARGE OF INDEBTEDNESS

Bankruptcy Exemption

***In re: Ernest W. Willis*, No. 07-11010, U.S. Bankruptcy Court for the Southern District of Florida (Aug. 6, 2009)**
IRC §§408, 4975, and 6871

☞ Prohibited Transactions Disqualify IRA Funds from Bankruptcy Exemption

Facts. Ernest Willis filed for relief under Chapter 7 of the Bankruptcy Code on February 16, 2007. He claimed exemptions for the full value of his three IRA accounts: a Merrill Lynch IRA valued at $1,247,000; an AmTrust Bank IRA valued at $109,000; and a Fidelity Federal IRA valued at $143,000. The trustee and creditor (movants) objected to Mr. Willis' exemptions for the IRAs.

The movants' objections regarding the Merrill Lynch IRA were that Mr. Willis used funds from the IRA to purchase an assignment of mortgage and to cover a shortfall in a joint personal stock brokerage account that he owned with his wife.

Mr. Willis claimed an exemption for an AmTrust IRA that he funded with Merrill Lynch IRA funds. He subsequently withdrew $108,433 on October 27, 2006 to close the AmTrust IRA and authorized AmTrust Bank to issue a check to him in that amount. He deposited the funds into a checking account with Fidelity Bank. On or about December 27, 2006, Mr. Willis issued a check to himself for $108,433 against the Fidelity Bank checking account and completed an IRA contribution form for a new AmTrust IRA account. He completed an IRA rollover form for AmTrust IRA 8629, indicating a contribution of $108,433.

Mr. Willis transferred $60,000 from his Merrill Lynch IRA to his Fidelity IRA. The record is unclear as to certain factual issues involving the remaining balance of funds in the Fidelity IRA. Mr. Willis and the creditor agreed that an IRA with Fidelity bank contained funds from an AmTrust IRA ending in 0440 which Mr. Willis opened in May 1998. However, neither Mr. Willis nor the creditor were able to establish whether the funds were deposited into the Fidelity IRA that Mr. Willis claimed as exempt or to determine the source of the funds in the AmTrust IRA ending in 0440.

Issues. Whether Mr. Willis is entitled to bankruptcy exemptions for the full value of the Merrill Lynch IRA, the Fidelity IRA, and the AmTrust IRA.

Analysis. 11 USC §522(b)(4)(A) provides that retirement funds "shall be presumed" to be exempt from the bankruptcy estate where retirement funds have received an IRS favorable determination. To rebut this presumption, the movants argued that Mr. Willis is a disqualified person who engaged in prohibited transactions with the Merrill Lynch IRA, which disqualified the IRA from bankruptcy estate exemption.

The creditor argued that because Mr. Willis funded the AmTrust IRA ending in 8629 with nonexempt funds, the AmTrust IRA is disqualified from bankruptcy estate exemption under 11 USC §522(b)(3)(C). IRA funds rolled over from a nonqualified account retain nonqualified status.[4] The funds in the AmTrust IRA ending in 8629 can be traced to funds from the Merrill Lynch IRA after it ceased to be exempt as a result of Mr. Willis engaging in prohibited transactions.

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4. *See In re Swift*, 124 B.R. 475, 485 (Bankr. W.D. Tex. 1991) (*citing* 26 U.S.C. §408(d)(3)(A)(ii)); *In re Banderas*, 236 B.R. 837, 840 (Bankr. M.D. Fla. 1998) (*citing Baetens v. Comm'r*, 777 F.2d 1160, 1167 (6th Cir. 1985)).

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The creditor further argued that the Fidelity IRA was also funded with nonexempt Merrill Lynch IRA funds, and therefore the Fidelity IRA is disqualified from bankruptcy estate exemption. The creditor presented evidence that Mr. Willis funded the Fidelity IRA with $60,000 from the Merrill Lynch IRA after the Merrill Lynch IRA ceased to be exempt as a result of Mr. Willis engaging in prohibited transactions.

Holding. For the reasons stated above, the court determined that all the funds in the Merrill Lynch IRA, all the funds in the AmTrust IRA, and $60,000 in the Fidelity IRA are not exempt from the bankruptcy estate.

BUSINESS EXPENSES

Business Expenses

***Ernestine Forrest v. Comm'r,* TC Memo 2009-228 (Oct. 5, 2009)**

IRC §162

☞ Attorney Not Allowed to Deduct Business Expenses for Sporadic Activity

Facts. Ernestine Forrest was admitted to practice law in California in 1974 and in Colorado in 1986. She worked as a contract attorney performing legal services for other attorneys until 1988. From 1988 to 2000, she worked for the California Department of Corporations (the Department) as a securities regulator. Her employment with the Department was terminated in 2000, and she then worked again as a contract attorney in 2000 but not during 2001 and 2002.

Ms. Forrest decided to try working again as a contract attorney in 2003. She attended the ABA 2003 Midyear Meeting in Seattle in February. At this meeting, she attended seminars and networked with colleagues, informing them she was available to work as a contract attorney.

Between January and March 2003, Ms. Forrest purchased various supplies and telephone, fax, and Internet services. During this time, she also filed suit to be reinstated as a securities regulator by the Department. She was reinstated by the Department and returned to work around March 25, before she had earned any 2003 income as a contract attorney.

Ms. Forrest filed her 2003 income tax return on October 15, 2006. She included a Schedule A with her return, on which she claimed $19,193 in various business and professional expenses. She did not include Schedule C, *Profit or Loss from Business*, or Form 6251, *Alternative Minimum Tax—Individuals*, with her return.

The IRS assessed a $1,882 deficiency in Forrest's 2003 federal income tax return from failure to report AMT liability. Ms. Forrest conceded the AMT adjustment but asserted that $1,761 of her Schedule A expenses should be reclassified as Schedule C business deductions.

Issues. Whether Ms. Forrest is entitled to deduct certain business expenses under IRC §162(a).

Analysis. Ms. Forrest asserted that she carried on a trade or business working as a contract attorney during 2003 and that she paid expenses in connection with this activity. The IRS's position was that she was not engaged in a trade or business because she had no clients and reported no income from the activity during 2003.

IRC §162(a) allows a deduction for ordinary and necessary expenses incurred in carrying on any trade or business. These expenses must relate to a functioning trade or business at the time the expenses were incurred. For a taxpayer to be engaged in a trade or business, the taxpayer's involvement must be regular and continuous, and the taxpayer's primary purpose for engaging in the activity must be for income or profit.[5]

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5. *Comm'r v. Groetzinger,* 480 U.S. 23 (1987).

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Ms. Forrest stated that her activity was a continuation of a trade or business carried on in the 1980s and again in 2000. However, she did not work as a contract attorney between 1988 and 2000. She also did not work as a contract attorney in 2001 or 2002, and her 2003 activity was sporadic. Accordingly, her activity as a contract attorney was neither regular nor continuous.

Holding. Ms. Forrest failed to prove the existence of a trade or business as a contract attorney in 2003 and is not entitled to deduct business expenses under §162(a).

CASUALTY AND THEFT LOSSES

Casualty Loss

***Justin M. Rohrs v. Comm'r,* TC Summ. Op. 2009-190 (Dec. 10, 2009)**

IRC §§165 and 6662

☞ Driver Cited for DUI Allowed to Claim Casualty Loss Deduction

Facts. Justin Rohrs purchased a 2006 Ford pickup truck on August 12, 2005, for $40,210. On October 28, 2005, he attended a party at a friend's house. He expected to drink alcohol at the gathering and consequently arranged for transportation to and from his house. After returning home from the party, Rohrs decided to drive to his parents' house. On the way there, his truck slid off an embankment after he failed to negotiate a turn. Rohrs was cited and arrested for driving under the influence of alcohol (DUI) because his blood-alcohol level was .09%, and the legal threshold in California is .08%.

Rohrs' insurance claim for the accident was denied under the terms of his policy because of his DUI citation and arrest.

Rohrs filed his 2005 Form 1040 on April 13, 2006, and claimed a $33,629 casualty loss deduction for the damage to his truck. In March 2008, the IRS issued a notice of deficiency disallowing Rohrs' casualty loss deduction and assessing a $6,230 income tax deficiency and a $1,246 IRC §6662(a) accuracy-related penalty.

Issues. Whether Rohrs is entitled to a casualty loss deduction for 2005 and whether he is liable for the §6662(a) accuracy-related penalty.

Analysis. IRC §165 allows an individual to deduct uncompensated losses arising from casualty or theft. Negligence does not preclude a casualty loss deduction, although gross negligence may.[6] The regulations provide that an automobile may be the subject of a casualty loss if the damage is not due to the willful act or willful negligence of the taxpayer.[7]

Rohrs concedes that his actions of driving while intoxicated were negligent but does not believe that his behavior rose to the level of gross or willful negligence. The IRS disagrees; accordingly, they contend that a casualty loss deduction is barred.

"Willful negligence" and "gross negligence" are not defined in the Code or Regulations. These definitions are supplied by case law. In *People v. Bennett*, the California Supreme Court defined gross negligence as "the exercise of so slight a degree of care as to raise a presumption of conscious indifference to the consequences."[8] In *People v. VonStaden*, the court held that conscious indifference could be inferred from the severity of the defendant's intoxication.[9]

The court in this case stated that Rohrs' level of intoxication and the manner in which he drove do not suggest that he was consciously indifferent to the hazards of driving while intoxicated. He arranged for transportation home from the party and thus allowed some time for his body to process the alcohol.

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6. *Heyn v. Comm'r*, 46 TC 302, 308 (1966).
7. Treas. Reg. §1.165-7(a)(3).
8. *People v. Bennett*, 819 P.2d 849 (Cal. 1991).
9. *People v. Von Staden*, 241 Cal. Rptr. 523, 527 (Ct. App. 1987).

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There is also no evidence that excess speed or alcohol directly caused Rohrs' accident. He claimed that he lost control of his truck because of windy conditions on the road. No evidence was presented at trial as to the precise cause of the accident.

Holding. Rohrs is entitled to the claimed casualty loss deduction. Accordingly, he is not liable for the §6662(a) accuracy-related penalty.

Theft Loss Deduction

***Dominick J. Vincentini v. Comm'r,* TC Memo. 2009-255 (Nov. 9, 2009)**

IRC §165

☞ Theft Loss Deduction for Investment in Fraud Scheme Denied

Facts. Dominick Vincentini was an investor in Anderson Ark & Associates from 1999 to 2001. Anderson Ark was an international fraud scheme that marketed various phony investment programs. Several of Anderson Ark's principals were arrested and indicted by U.S. officials in 2001. In 2004, these Anderson Ark principals were convicted of conspiracy to defraud the United States, conspiracy to commit mail and wire fraud, aiding and assisting the filing of false income tax returns, mail fraud, and various other charges. The defendants were each sentenced to prison terms of up to 20 years. In 2005, the Washington District Court entered amended judgments in which the defendants were ordered to pay restitution to investors, which included Vincentini.

In April 2006, Vincentini submitted a Form 1040X, *Amended U.S. Individual Income Tax Return*, for 1999. The amended return included Form 4684, *Casualties and Thefts*, in which Vincentini claimed an $835,000 theft loss deduction related to his investment with Anderson Ark. Vincentini asserted that the theft loss occurred in 2001 or 2002 and that he could carry it back to 1999.

Issues. Whether the court should reconsider its previous finding that Vincentini is not entitled to a theft loss deduction for his investment in a fraudulent investment program.

Analysis. IRC §165 generally permits a taxpayer to deduct uncompensated losses resulting from theft in the year in which the loss is discovered. To qualify for the deduction, the taxpayer must prove:

- The occurrence of a theft,
- The amount of the theft loss, and
- The date the taxpayer discovered the theft loss.

A theft loss deduction is not allowed if there is a reasonable prospect of recovery.[10]

In the first trial, the court concluded that Vincentini had suffered a theft loss of $511,500 and that the loss was discovered in 2001. His theft loss deduction was denied by the court, however, because he did not prove that he had no reasonable prospect of recovery in 2001 or 2002. The court stated that it was likely that the Anderson Ark defendants would be convicted of various charges related to the investment schemes and that, if they were convicted, it was expected that the defendants would be ordered to pay restitution to their victims.

In his motion for reconsideration, Vincentini argued that the likelihood of recovery was not 40% or greater. However, he failed to convince the court that any uniform standard had been adopted by the courts for quantifying whether a taxpayer's prospect of recovery is reasonable. The court stated that even if they were to accept Vincentini's contention that a reasonable prospect of recovery means a chance of recovery that is 40% or better, he did not satisfy his burden of proving that his prospect for recovery was less than 40%.

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10. Treas. Reg. §1.165-1(d)(3).

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Vincentini also did not offer any convincing evidence that the Anderson Ark defendants were judgment proof, that they had insufficient assets to satisfy the restitution orders, or that it was otherwise improbable that he would receive restitution.

Holding. Vincentini's motion for reconsideration was denied.

DEDUCTIONS

Illegal Deductions Claimed

***William G. Halby v. Comm'r,* TC Memo 2009-204 (Sept. 14, 2009)**

IRC §§213 and 6662

☞ Tax Attorney Not Allowed Deductions for Prostitutes and Pornography

Facts. William Halby is a tax attorney residing in New York. During 2004 and 2005, he visited prostitutes in New York and purchased pornography and books and magazines on sex therapy. He recorded the dates and amounts of the costs incurred in a journal.

Halby timely filed his 2004 and 2005 Forms 1040, on which he claimed $76,314 and $49,203 of medical expense deductions on his Schedules A for those years, respectively. His returns included attachments to Schedule A which provided vague descriptions of the types of costs Halby was claiming as deductions.

The IRS issued Halby a notice of deficiency on June 21, 2007. The notice disallowed $73,934 of Halby's claimed medical expense deductions for 2004 and $47,024 of his claimed medical expense deductions for 2005. The disallowed deductions included amounts spent for books, magazines, videos, pornographic material, prostitutes, and bank and finance charges incurred in connection with loans used to pay for the expenses.

Issues. Whether petitioner is entitled to the claimed medical expense deductions in 2004 and 2005 and is liable for the IRC §6662 accuracy-related penalty for those years.

Analysis. The IRS stated that Halby is not entitled to deduct amounts paid to prostitutes because such payments are illegal. He also did not provide substantiation as required by Treas. Reg. §1.213-1(h). The IRS also argued that Halby is not entitled to deduct amounts paid for books on sex therapy and pornographic material because those amounts were not pursuant to a doctor's prescription or for a specific medical condition.

Halby cited book and magazine articles about the positive health effects of sex therapy and argued that he should be allowed the deduction despite the illegality of his conduct or the lack of a doctor's prescription.

The court agreed with the IRS that patronizing a prostitute is illegal in the state of New York. Treas. Reg. §1.213-1(e)(1)(ii) states that a taxpayer is not entitled to deduct any illegal operations or treatments. The court also stated that Halby's purchases of books and magazines on sex therapy and pornography were not for the treatment of a medical condition but were instead personal items.

Halby did not have reasonable cause or basis for claiming the deductions at issue, according to the court. Halby has been an attorney for 40 years, and he specialized in tax law. He should have known that his visits to prostitutes were illegal in New York and that case law did not support his claimed deductions.

Holding. The court held that Halby is not entitled to deductions for amounts paid for books, magazines, and prostitutes. He was also found liable for the §6662 accuracy-related penalty.

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Education Expenses

***Lori A. Singleton-Clarke v. Comm'r,* TC Summ. Op. 2009-182 (Dec. 2, 2009)**

IRC §162

☞ Registered Nurse Allowed to Deduct Educational Expenses for MBA Degree

Facts. Lori Singleton-Clarke obtained a Bachelor of Science degree in nursing in 1984. She then became a registered nurse (RN) and worked in various capacities for the next 24 years for a number of hospitals and long-term care facilities. From 1993 to 2004, Singleton-Clarke held various nursing management positions of increasing responsibility. From 2004 to 2008, she worked at three different hospitals where her responsibilities were nearly identical.

In March 2005, Singleton-Clarke began taking online courses through the University of Phoenix. She graduated in April 2008, obtaining an MBA with a specialization in Health Care Management. Singleton-Clarke paid the entire cost of the MBA program herself.

Singleton-Clarke timely filed her 2005 federal income tax return. The IRS examined her return and issued a notice of deficiency, disallowing $14,787 in unreimbursed employee business expenses for education expenses.

Issues. Whether Singleton-Clarke is entitled to deduct education expenses she paid in 2005 in connection with the MBA degree.

Analysis. Treas. Reg. §1.162-5 provides that a taxpayer may deduct education expenses if the education:

- Maintains or improves skills required by the individual in her employment or other trade or business; or
- Meets the requirements imposed as a condition to the retention by the individual of an established employment relationship, status, or rate of compensation.

The regulations conversely state that if the education qualifies the individual for a new trade or business, then the education expenses are not deductible.[11]

In the three jobs that Singleton-Clarke held since 2004, she served as a quality control coordinator at acute care hospitals and medical centers. All three positions required an RN license or a Bachelor's Degree in nursing, with clinical or risk management experience. She was hired for the first two jobs she held during this period before she obtained the MBA degree. She was hired by St. Mary's Hospital in September 2008, a few months after she received her MBA degree.

The court has had differing outcomes in deciding whether taxpayers may deduct education expenses related to pursuing an MBA degree, depending on the facts and circumstances of each case. The decisive factor is generally whether the taxpayer was already established in her trade or business. In Singleton-Clarke's situation, she had already worked as a quality control coordinator and had over 20 years of related work experience, during which she gained vast clinical and managerial knowledge in health care settings before she began the MBA program. In summary, the MBA may have improved Singleton-Clarke's skills, but she was already performing the required tasks of her trade or business before commencing the MBA program.

Holding. Singleton-Clarke's MBA degree did not qualify her for a new trade or business; therefore, she was entitled to deduct her education expenses for 2005.

11. Treas. Reg. §1.162-5(b)(3).

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GROSS INCOME

Life Insurance Policy

Harvey S. and Willyce Barr v. Comm'r, TC Memo. 2009-250 (Nov. 3, 2009)
IRC §§61, 72, and 6662

☞ **Surrender of Life Insurance Contract Results in Recognition of Ordinary Income**

Facts. Harvey Barr has been an attorney since 1964 and specializes in complex commercial transactions and bankruptcy law. He is admitted to practice before the U.S. Tax Court, several U.S. District Courts, the U.S. Court of Appeals for the Second Circuit, and the U.S. Supreme Court.

Mr. Barr's mother, Lillian Barr (Ms. Barr) purchased a life insurance policy in 1980 to help her children pay the anticipated estate tax liability after her death. It was a whole life policy with a face amount of $200,000 and had Mr. Barr and his sister, Susan Roe, as co-owners and beneficiaries of the policy.

For the first eight or nine years of the policy, Ms. Barr gifted the amount of the premiums to Mr. Barr and Ms. Roe, who then paid the premiums directly. After that, no additional payments were made by Mr. Barr or Ms. Roe. Instead, the premiums were automatically paid from dividend accumulations and loans against the cash value of the policy.

In 2005, the current holder of the policy, New England Financial (a MetLife affiliate), sent a letter to Mr. Barr explaining the tax consequences of the policy, along with a statement of gain. The letter stated that gain must be recognized as taxable income to the extent any cash received or loan extinguished exceeds the total net investment. A second statement of gain was sent to Mr. Barr in September 2005, which listed the net investment in the policy as $225,390, the total cash value as $361,353, the total indebtedness as $354,399, and the taxable gain as $135,963.

After discussion with Ms. Barr, Mr. Barr allowed the policy to terminate because it was no longer necessary. Mr. Barr surrendered the policy in December 2005. At that time, he was the sole owner and beneficiary.

In 2005, Mr. Barr received and cashed a check from the insurance company for $11,648 and a dividend check for $304. In January 2006, he received a Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.,* from MetLife showing a gross distribution and taxable amount of $135,963 for 2005 and a 1099-DIV, *Dividends and Distributions,* showing a $304 taxable dividend.

Mr. Barr timely filed a federal income tax return jointly with his wife for 2005. The gross income reported by the couple did not include either the $135,963 shown on Form 1099-R or the $304 shown on Form 1099-DIV.

Issues. Whether the Barrs recognize ordinary income or capital gain from the surrender of the life insurance policy and whether they are liable for the IRC §6662(a) penalty.

Analysis. Upon surrender of a life insurance contract, any amount received that is not payment under an annuity is included in gross income to the extent that it, when added to amounts previously received under the contract and excluded from gross income, exceeds the investment in the contract.[12]

When the policy terminated, Mr. Barr received a net distribution of $11,648, which represented the total cash value of $361,354, plus a terminal dividend of $4,694, less $354,399 withheld to repay the outstanding policy loan balance. The satisfaction of the policy loans had the effect of paying the policy proceeds to Mr. Barr and constituted income to him at that time. Thus, Mr. Barr constructively received the cash value of $361,354 upon surrender of the policy before reduction for outstanding loans. His net investment at that time was $225,390. As a result, he is taxable under IRC §72(e) on the $135,963 reported to the IRS on Form 1099-R.

12. IRC §§72(e)(5)(A), (C); Treas. Reg. §1.72-11(d)(1).

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The surrender of an insurance policy is not an exchange or sale of a capital asset and therefore does not result in capital gain. Mr. Barr argued that the facts in this case are so exceptional as to require capital gain treatment. The court disagreed, stating that nothing about the policy or the manner in which it was surrendered is exceptional.

When there is a substantial understatement of income tax or negligence or disregard of rules or regulations, the accuracy-related penalty is imposed unless the taxpayer acted with reasonable cause and in good faith.[13] Mr. Barr is an experienced attorney admitted to practice before the Tax Court. He knew, or should have known, that any proceeds paid out or gain recognized to him as the owner and beneficiary of the policy would be taxable to him. Therefore, his failure to report income shown on Form 1099-R was not on account of reasonable cause and good faith.

Holding. Mr. Barr and his wife recognized $135,963 of ordinary income in 2005 from the surrender of the life insurance policy and are liable for the accuracy-related penalty.

Wrongful Death Claim

Ltr. Rul. 200940006 (Oct. 2, 2009)
IRC §104

☞ Compensatory Damage Award for Wrongful Death Excludable From Income

Facts. The taxpayer was the survivor of a victim killed in an incident for which a governmental entity was responsible. The taxpayer was one of the parties to a lawsuit filed by the estates of those killed and their survivors in which the taxpayer sought recovery for intentional infliction of severe emotional distress caused by the death of one of those killed in the incident.[14] The court granted the taxpayer a portion of an aggregate recovery awarded to the plaintiffs for compensatory damages, prejudgment interest, and punitive damages.

While the court's damage award was on appeal, the taxpayer sold the rights to a portion of the damage award to an investor in exchange for an immediate cash payment, plus a graduated rate of return. Later, an Act was passed which provided compensation to all parties who had claims for wrongful death and physical injury against the governmental entity. Pursuant to the Act, the prior court award of damages to the plaintiffs was voided and vacated; and procedures were established to compensate victims under the agreement.

The taxpayer filed a request for a ruling to determine whether the funds received from the wrongful death claim are excludable from gross income under IRC §104(a)(2).

Analysis. IRC §104(a)(2) specifies that the amount of any damages received, whether by suit or agreement, on account of personal physical injuries or sickness is excludable from gross income. This exclusion applies to any damages received based on a claim of emotional distress that is attributable to physical injury or sickness.[15]

The taxpayer was awarded compensatory damages, interest, and punitive damages on a claim of intentional infliction of severe emotional distress. The taxpayer exchanged the right to recover a portion of the award for an immediate cash payment, which takes the place of the court's award.

Holding. The compensatory damages awarded to the taxpayer are excludable from gross income under §104(a)(2).

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13. IRC §6664(c)(1).

14. The relationship of the taxpayer to the victim and other details about the incident have been redacted from the text of the letter ruling.

15. H.R. Conf. Rep. No. 104-737 at 301 (1996).

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INFORMATION REPORTING

Information Returns

IRS Notice 2010-9
IRC §§6041 and 6045

☞ Deadline for Certain Information Returns is February 16, 2010

Purpose. This notice provides additional time for furnishing certain annual tax reporting statements from calendar year 2009.

Analysis. Filers of the following statements have until February 16, 2010, to furnish the required information to their customers:

- Forms 1099-B, *Proceeds from Broker and Barter Exchange Transactions*;
- Forms 1099-S, *Proceeds from Real Estate Transactions*; and
- Forms 1099-MISC, *Miscellaneous Income*, when reporting payments to attorneys or substitute payments by brokers in lieu of dividends or interest.

The additional time applies only to items that must be reported to recipients based on the same relationship between the reporting entity and the recipient as required by IRC §6045 (e.g., brokers, payors, or real estate settlement agent to customer) and not as a result of any other relationship between the parties (e.g., debtor to creditor or employer to employee). For the relationships covered by §6045, the February 16, 2010 deadline also applies to the following forms:

- Form 1099-DIV, *Dividends and Distributions*;
- Form 1099-INT, *Interest Income*;
- Form 1099-OID, *Original Issue Discount*;
- Form 1099-PATR, *Taxable Distributions Received From Cooperatives*;
- Form 1099-Q, *Payments From Qualified Education Programs (Under Sections 529 and 530)*;
- Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*; and
- Form 5498, "*IRA Contribution Information*.

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INVOLUNTARY CONVERSION

Involuntary Conversion

Ltr. Rul. 200944012 (Oct. 30, 2009)
IRC §1033

☞ Taxpayer Allowed Three Years to Replace Condemned Property

Facts. The taxpayer is in the business of owning and leasing real property. The taxpayer acquired certain property and leased it to commercial tenants. A city agency later filed a condemnation action to acquire the property. The city agency deposited funds (the Deposit) with the state treasurer as "probable compensation" for the property. The taxpayer later filed an answer to the condemnation action, in which it raised certain affirmative defenses to challenge the city agency's right to take the taxpayer's property.

The taxpayer could have applied to withdraw the Deposit at any time under the state's eminent domain law. In doing so, however, the taxpayer would have abandoned its challenge to the city agency's right to take the property. The relevant statutes provide that withdrawal of any portion of the money deposited effects a waiver of all claims and defenses to the taking of the property except for a claim for greater compensation.

The taxpayer did not apply to withdraw the Deposit in Year 1 because it was unwilling to abandon its challenge of the city agency's action at that time. However, in Year 2, the taxpayer entered into a settlement agreement with the city agency. Accordingly, the taxpayer received its share of the deposited funds later in Year 2.

When the taxpayer filed its Year 2 Form 1065, *U.S. Return of Partnership Income*, it attached a statement electing to defer gain pursuant to IRC §1033.

Analysis. IRC §1033(a)(2)(A) provides that if property is compulsorily or involuntarily converted into money or property, the taxpayer may elect to recognize the gain (if any) only to the extent the amount realized from the conversion exceeds the cost of replacement property similar or related in service to the converted property. The taxpayer generally has two years from the close of the taxable year in which any gain from the conversion is realized to acquire the replacement property. However, the replacement period extends until the close of the third taxable year for conversions that are condemnations of real property held for productive use of a trade or business or for investment.[16]

A taxpayer realizes gain from the involuntary conversion of property when it actually or constructively receives money or property in excess of the converted property's basis. Money or property is constructively received when it is available for the taxpayer to draw upon without substantial restriction or limitation. In this situation, the taxpayer's withdrawal of any portion of the Deposit constituted a waiver of all claims and defenses with respect to the converted property except a claim for greater compensation. This waiver is a substantial limitation or restriction to the taxpayer's access to the Deposit. As a result, the taxpayer did not have actual or constructive receipt of the Deposit until Year 2, when the parties entered into a settlement claim.

Holding. Year 2 was the first year in which any part of the gain from conversion was realized. Under §1033(g), the taxpayer has three years from the close of Year 2 to replace the condemned property with qualifying replacement property.

16. IRC §1033(g).

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IRS PROCEDURES — MISCELLANEOUS

Licensing

IRS FS-2010-1 (January, 2010)

☞ IRS Mandates Paid Tax Return Preparer Registration

The IRS released a comprehensive set of recommendations[17] designed to foster increased compliance with tax laws and better service to taxpayers through higher standards of conduct by paid return preparers.

The IRS believes that this increased oversight of paid return preparers does not require the passage of additional legislation. Therefore, the IRS intends to implement the following measures during the next few years. These steps will not be effective for the 2010 filing season.

- **Mandatory Registration.** The IRS will require all individuals who are obligated to sign federal tax returns as paid preparers to register with the IRS and obtain a preparer tax identification number (PTIN). A nonrefundable fee may be required in order to register as a tax return preparer.

  Registration renewals will be required every three years. Tax return preparers will also be subject to a compliance check as part of the renewal process.

  The IRS will consider extending the registration requirement to all tax return preparers, although only signing tax return preparers will initially be required to register.

- **Competency Testing.** After registering, paid tax return preparers will be required to take a competency test. CPAs, attorneys, and enrolled agents are exempt from this requirement since they must already pass competency tests. However, the IRS has announced that it will study the tax return accuracy of attorneys and CPAs to determine if this exemption from testing is warranted.

  A transition rule will give existing preparers approximately three years to meet the testing requirement. Two levels of competency examinations will be offered initially. The first test will cover wage and non-business Form 1040 series returns, and the second test will cover wage and small business Form 1040 series returns. Proposed content of the examinations is shown in the chart on the following page.

17. See full report at [www.irs.gov/pub/irs-pdf/p4832.pdf]. Accessed Jan. 5, 2010.

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Competency Examination Content

Wage & NonBusiness Income Form 1040 Examination		
FORMS		**INCOME**
1040EZ	8606	Cash
1040A	8812	
1040A Schedules 1, 2 and 3	8821 Tax Information Authorization	W-2
1040	8859 DC First Time Home Buyers Credit	W2G
1040 Schedules A, B, C-EZ, D, D-1, EIC, L, M, R, SE	8863	1098
2106EZ	8867	1098E Student Loan Interest
2120	8879	1098T
2441	8880	1099B
2555EZ	8888 Direct Deposit Voucher	1099C
3903	8889	1099DIV
4137 Unreported Tip Income	8917	1099G
4868 Extension of Time to File	9465 Request for an Installment Agreement	1099INT
5405 First Time Home Buyers Credit	1040ES	1099 MISC (box 9)
8283	1040X	1099 OID
8332	1040V	1099 R
8379 Injured Spouse	W-4/W-4P/W-4V	
8453	W-7	

Wage & Small Business Income Examination		
ALL ITEMS FROM WAGE AND NONBUSINESS INCOME EXAMINATION		
FORMS		
1040NR	4835	8862
1040PR	4952	8885
1040 Schedules C, D and F	5329	8903
1116	6198	8910
2106	6251	8919
2210	6252	
2439	8283	**INCOME**
2555	8396	1041 K-1
3800	8582	1065 K-1
4136	8801	1099A
4562	8814	1120S K-1
4684	8824	
4797	8839	

The IRS will determine whether additional tests are necessary by monitoring the results of the initial testing process. Additionally, the IRS plans to add a third test on business tax preparation after the completion of the initial implementation phase.

Preparers who test during the initial 3-year implementation period will be permitted to sit for the examination as often as necessary until they pass the test. However, the applicable fee must be paid for each attempt.

Individuals will be permitted to register as tax return preparers and receive PTINs during this initial implementation phase even if they have not yet passed the examination(s).

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- **Continuing Education.** Attorneys, CPAs, enrolled agents, enrolled actuaries, and enrolled retirement plan agents are generally required to obtain continuing education to maintain their professional credentials. Other paid preparers will be required to complete 15 hours of continuing education annually. The requirement includes three hours of federal tax law updates, two hours of tax ethics, and 10 hours of other federal tax law topics.
- **Ethical Standards.** The IRS proposes requiring all signing and nonsigning tax return preparers to comply with the provisions of Treasury Department Circular 230. This will make them subject to discipline for unethical and unprofessional conduct. The authority of tax return preparers who are not attorneys, CPAs, enrolled agents, enrolled actuaries, or enrolled retirement plan agents will be limited to preparing tax returns and representing their clients as currently permitted during the examination of any return prepared by that tax return preparer.
- **Enforcement.** The IRS's strategy will include the issuance of new guidelines that apply examination and collection resources to tax return preparer compliance. The priority of tax return preparer penalties in IRS Collection will be elevated. Further, the IRS will consider the use of targeted notices that oblige tax return preparers to correct instances of noncompliance. The IRS may not pursue penalties if the tax return preparer self-corrects the noncompliance issue.

Litigation Costs

***James T. and Tiffany A. Manning v. Comm'r,* TC Memo. 2009-277 (Nov. 30, 2009)**
IRC §§7430 and 6673

☞ Substantially Prevailing Party Unable to Recover Litigation Costs

Facts. James Manning operated Assent, LLC in Austin, Texas, through his wholly-owned entity, James T. Manning, LLC (a disregarded entity). Manning deducted large commission payments to the Warrior Fund, which was owned by Manning's brother, on the joint income tax return he filed with his wife. The IRS subsequently investigated the Warrior Fund in connection with an alleged abusive tax shelter. As a result of this investigation, the IRS examined the Mannings' tax return and issued a deficiency notice which disallowed the commission deductions and assessed an accuracy-related penalty.

The primary argument the IRS used to disallow the commission deductions was that the payments to Warrior were not deductible under IRC §162(a) because the payments were not ordinary and necessary business expenses. Using alternative theories, the IRS argued that the payments were nondeductible illegal payments and that they were not deductible because they lacked economic substance.

The Mannings admitted that $100,000 of the commission adjustments in 2003 were mistakenly deducted. At trial, the court held that the Mannings were entitled to the other deductions at issue, that they did not have $208,329 in unreported income, and that they were not liable for the accuracy-related penalty. The Mannings then filed a motion to recover litigation costs of over $250,000 from the IRS.

Issues. Whether the Mannings are entitled to recover litigation costs.

Analysis. In order to recover reasonable litigation costs in any court proceeding brought by or against the United States involving the collection or determination of tax, a prevailing party must establish:

1. The party has exhausted available administrative remedies,
2. The party has substantially prevailed in the controversy,
3. The party satisfies certain net worth requirements,
4. The party has not unreasonably protracted the proceedings, and
5. The amount of costs is reasonable.[18]

The failure to satisfy any of the above requirements precludes an award of litigation costs.

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The IRS acknowledged that the Mannings "substantially prevailed" in the proceedings; however, they argue that the Mannings should not be deemed the prevailing party because the IRS's positions were substantially justified.

If the Government establishes that its position was substantially justified, the moving party will not be treated as having prevailed.[19] The IRS's position may be incorrect yet substantially justified if the IRS had a reasonable basis in law and fact for its position.

The court found that the IRS was substantially justified in arguing that the commission deductions were not deductible, even though the Mannings were held to be entitled to the deductions. The payments were between family members and family-controlled businesses; such transactions present greater possibilities for abuse and require closer scrutiny. Further, Mr. Manning's brother was under investigation for allegedly participating in an abusive tax shelter. Because of this relationship, the IRS's position was substantially justified.

Holding. The Mannings are not allowed to recover any litigation costs.

Taxpayer Identification Numbers

IRS Notice 2009-93, IRB 2009-51
IRC §§6721 and 6109

☞ Pilot Program Allows Use of Truncated ID Numbers on Payee Information Returns

Purpose. This notice creates a pilot program which allows filers of certain information returns to truncate an individual payee's identifying number on paper payee statements for calendar years 2009 and 2010.

Analysis. In order to be authorized to truncate identifying numbers for individuals on paper payee statements furnished for calendar years 2009 and 2010, a filer must satisfy the following requirements:

- The identifying number must be a social security number, IRS individual taxpayer identification number, or IRS adoption taxpayer identification number;
- The identifying number is truncated by replacing the first five digits of the nine-digit number with asterisks or Xs (e.g., a social security number 123-45-6789 would appear on the paper payee statement as ***-**-6789 or XXX-XX-6789); and
- The truncated identifying number appears only on paper payee statements in the Form 1098, Form 1099, or Form 5498 series for calendar year 2009 or 2010.

Truncated identification numbers are not allowed on information returns filed with the IRS, electronically-furnished payee statements, or any payee statements not in the Form 1098, Form 1099, or Form 5498 series.

The IRS invites public comments on this notice to be submitted by May 1, 2010.

18. IRC §§7430(b) and (c).
19. IRC §7430(c)(4)(B).

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Tax Return Processing

Treasury Inspector General for Tax Administration Report #2009-40-130 (Sept. 10, 2009)

☞ Actions to Reduce Number of Paper Tax Returns Filed Recommended by TIGTA

Purpose. The Treasury Inspector General for Tax Administration (TIGTA) issued this report to present the results of its review of the IRS's efforts to convert paper-filed individual income tax returns into an electronic format.

Analysis. Despite a continued growth in e-filing, the IRS continues to receive large numbers of paper-filed individual income tax returns. The processing of these returns costs the IRS approximately $190.6 million. Because a modernized processing system to convert paper tax returns into an electronic format has not been implemented, the IRS has to continue to use a labor intensive, costly, and error-prone system.

The options that could result in a significant increase in e-filing and generate significant cost savings to the IRS include the following:

- Mandate e-filing for paid preparers. This option would require a change in the law.
- Convert paper returns into an electronic format.

The TIGTA report says that implementing these two options could result in a 26.9% increase in e-filing, with associated cost savings of $66.6 million annually. Thus, TIGTA recommends that the IRS pursue implementing scanning technology to convert paper-filed tax returns into an electronic format. TIGTA also provides a legislative recommendation to consider mandating e-filing for all paid tax return preparers.

IRS management agreed with the two recommendations.

> **Note.** A provision in the Worker, Homeownership, and Business Assistance Act of 2009 mandates electronic filing for most tax return preparers for tax returns filed after December 31, 2010. See page 9 of this supplement for more information.

IRS PROCEDURES — PENALTIES

Accuracy-Related Penalty

***Kenneth and Linda Hopson v. Comm'r,* TC Summ. Op. 2009-130 (Aug. 25, 2009)**

IRC §§6662 and 6664

☞ Reliance on Tax Return Preparation Software Does Not Excuse Understatement

Facts. In 2006, Kenneth Hopson received distributions from the Ohio Public Employees Retirement System which totaled $60,882. The amount Mr. Hopson received was a full distribution of the retirement accounts he accumulated during his employment with the State of Ohio and the City of Cleveland. He requested the distributions in order to pay off credit card debt and a home equity loan. Mr. Hopson received Forms 1099-R, *Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*, for the distributions.

Mr. Hopson prepared a joint tax return for 2006 using tax return preparation software, as he had done since the 1980s. He completed the software's interview process, which required him to enter information necessary to generate the return, but he inadvertently failed to enter the information from the Forms 1099-R. Neither he nor Mrs. Hopson reviewed the federal income tax return generated by the software program for accuracy. The return listed the couple's total income as $88,488 and their total tax as $6,515. It was timely filed with the IRS.

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Issue. Whether the Hopsons are liable for the accuracy-related penalty under IRC §6662(a).

Analysis. IRC §§6662(a) and (b)(2) imposes a 20% underpayment penalty for a substantial understatement of income tax, which is defined as an understatement that exceeds the greater of 10% of the tax required to be shown on the return or $5,000. IRC §6664 provides an exception to the penalty if the taxpayer establishes reasonable cause for the understatement and that the taxpayer acted in good faith with respect to that portion.

The understatement on the Hopsons' 2006 return was $21,954, which exceeds the threshold for "substantial understatement." Mr. Hopson admitted receiving the Forms 1099-R, and he knew that they constituted income. The couple failed to review their return to ensure that all income items were included.

Holding. The court held that the Hopsons are liable for the accuracy-related penalty under §6662(a).

Failure to File Returns

***Andrew I. Walzer v. Comm'r,* TC Memo 2009-200 (Sept. 8, 2009)**

IRC §§6651, 6654, and 6072

☞ Day Trader Liable for Failure to File Penalties

Facts. Andrew Walzer began actively trading securities in 1996. He was engaged in day trading during 2001 and 2002, conducting hundreds of trades. He also ran a marking supplies business called Glo-Mark, which was a longtime family business that had recently struggled but was still profitable.

Walzer did not file federal income tax returns for 2001 and 2002, nor did he pay any federal income tax for those years. The IRS prepared substitute returns for Walzer for tax years 2001 and 2002 on November 13, 2006.

Walzer had the following income for the tax years at issue:

	2001	2002
Gross proceeds from sale of securities	$3,279,144	$3,483,750
Net short-term capital gain (loss)	137,451	(194,375)
Net long-term capital gain/(loss)	(97,128)	(81,606)
Dividend income	15,869	18,578
Interest income	220	54
Gross proceeds from Glo-Mark	62,814	

The parties to the lawsuit agreed that for the years at issue, Walzer was not in the trade or business of selling securities and was not entitled to deduct his expenses from the sale of securities on a Schedule C, *Profit or Loss From Business.*

Issues. Whether Walzer is liable for additions to tax under IRC §§6651(a)(1) and 6654 as follows:

		Additions to Tax	
Year	Deficiency	§6651(a)(1)	§6654
2001	$1,263,403	$284,266	$50,490
2002	1,326,288	298,415	44,321

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Analysis. IRC §6651(a)(1) imposes an addition to tax for failure to timely file a return, unless the taxpayer can establish that such failure is due to reasonable cause and not willful neglect. Walzer claimed his failure to timely file his returns was due to reasonable cause because he did not know he had to file returns. However, Walzer has an MBA degree from New York University and is not an unsophisticated taxpayer. In addition, his father is a retired accountant who advised him to hire an accountant to prepare his returns.

IRC §6654(a) imposes an addition to tax for any underpayment of estimated tax by an individual. Walzer did not pay any tax in 2001 or 2002, much less make any estimated tax payments.

Holding. The court held that Walzer is liable for the additions to tax pursuant to §6651(a)(1) and 6654(a) for 2001 and 2002.

Accuracy-related Penalty

***Kenneth D. and Trudi A. Woodard v. Comm'r,* TC Summ. Op. 2009-150 (Sept. 28, 2009)**

IRC §§6662, 6664, and 408

☞ CPA Did Not Exercise Ordinary Business Care in Relying on Internet Advice

Facts. Kenneth Woodard holds an undergraduate degree in accounting and earned an MBA from Harvard Business School. He was a CPA but allowed his CPA license to lapse during the period that he worked as a computer programmer.

In November 2004, Vanguard distributed $100,000 to Mr. Woodard from his contributory and rollover IRAs. In December 2004, Vanguard converted $50,000 from the contributory IRA to a Roth IRA. Vanguard reported two $50,000 distributions from the contributory IRA and one $50,000 distribution from the rollover IRA on Forms 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*

Mr. Woodard deposited $100,000 from Vanguard IRA distributions into his personal checking account in 2004. He wired funds to Amanda M. Mahn in February 2005 pursuant to demand notes and statutory mortgage documents executed by Ms. Mahn as debtor and Hunter Financial, LLC, as lender.

Mr. Woodard recorded the mortgages in Minnesota. At the time of recordation, a prior mortgage on the same property by Lake State Federal Credit Union (Lake State) had not been recorded. After Lake State failed to receive mortgage payments on the property in August through November 2005, it discovered that its mortgage had not been recorded, that the warranty deed on the property had been altered to add Ms. Mahn's name, and that the altered warranty deed had been used to obtain mortgage financing from Hunter Financial. Lake State initiated a foreclosure action against the property on December 5, 2005. The Minnesota District Court granted summary judgment to Lake State against Hunter Financial, finding the purported mortgage between Hunter Financial and Ms. Mahn to be void.

Mr. Woodard prepared a joint federal income tax return for 2004 but did not report the $150,000 in IRA distributions. His wife, Trudi, was not aware that he had taken any distributions from his IRAs.

The IRS issued a notice of deficiency resulting from the $150,000 in unreported distributions, determining a $27,606 deficiency and a $5,521 accuracy-related penalty. Mr. Woodard conceded that the IRA distributions are taxable income but challenged the IRC §6662(a) accuracy-related penalty.

Issues. Whether Mr. Woodard is liable for the accuracy-related penalty.

Analysis. IRC §6662 imposes a penalty of 20% for any underpayment of tax attributable to negligence or disregard of rules or regulations or to a substantial understatement of income tax. IRC §6664 allows for a defense to this penalty if a taxpayer establishes reasonable cause for the underpayment and that he acted in good faith. The most important factor in determining whether a taxpayer acted with reasonable cause and in good faith is the extent of the taxpayer's effort to assess the proper tax liability.[20]

[20] Treas. Reg. §1.6664-4(b)(1).

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Mr. Woodard stated that he thought he had a self-directed IRA and intended to reinvest the $100,000 in private mortgages. He searched the Internet for information about self-directed IRAs and followed the advice he found. He argued that he should not be liable for the accuracy-related penalty because he was dealing with a complicated area of the law, that he never intended to defraud the government, that he reaped no personal benefit from the money, and that he followed Internet instructions in managing his self-directed IRA.

Good-faith reliance on advice from an independent, competent professional regarding the tax treatment of an item may meet the reasonable cause requirement.[21] A taxpayer must act with prudence and ordinary business care to claim reasonable cause.[22]

Mr. Woodard claimed to rely on information found on unspecified websites written by unidentified individuals or organizations. It is not clear from the record whether he questioned the accuracy of the information he found online. Thus, the court was not able to determine if those sources were competent to provide tax advice and could not conclude that Mr. Woodard exercised ordinary business care and prudence in selecting and relying upon this information.

Holding. The court held that Mr. Woodard is liable for the accuracy-related penalty.

Disclosure

Rev. Rul. 2010-4, IRB 2010-4 (Jan. 4, 2010)
IRC §§6713 and 7216

☞ Disclosure of Certain Tax Return Information by Preparers Allowed

Purpose. IRC §§7216 and 6713 cover the disclosure or use of information by tax return preparers. This revenue ruling provides guidance on whether the disclosure of certain tax return information by tax return preparers subjects the preparer to penalties under IRC §§7216 and 6713.

> **Note.** For more information on §7216, see Chapter 1 of the 2009 *University of Illinois Federal Tax Workbook.*

Analysis. In the first scenario, tax return preparer A reviews income tax returns and other information of taxpayers whose income tax returns A prepared in previous year(s), in order to determine which clients may be able to benefit from recent changes to the net operating loss carryback period. Following this review, preparer A contacts the affected taxpayers to tell them about the change, advise them whether amended return(s) can be filed for years affected by the change, and offers A's services in preparing and filing the amended returns.

The use of tax return information in the manner presented in the first scenario is not prohibited under §7216. The tax return preparer may use client tax return information to identify affected taxpayers, inform them of changes in tax law, advise them whether it would be appropriate to file amended income tax returns, and assist in the preparation and filing of the amended returns. These uses are for the purposes of preparing a tax return as defined in the regulations.

In the second scenario, tax return preparer B uses tax return information of clients to determine which clients' future income tax return filing obligations may be affected by a prospective change in the tax rules or regulations. Preparer B uses this information to contact the potentially-affected taxpayers to notify them of the new rules, explain how the changes may affect them, and advise them with regard to actions they may take in response to the changes.

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21. Treas. Reg. §1.6664-4(b).

22. *Neonatology Associates, P.A. v. Comm'r,* 115 TC 43, 98 (2000), *aff'd* 299 F.3d 221 (3rd Cir. 2002).

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Treas. Reg. §301.7216-2(h)(1)(i) permits the use of tax return information by tax return preparers "for the purpose of providing other legal or accounting services to the taxpayer," in accordance with applicable legal and ethical responsibilities. Accordingly, preparer B may use tax return information to determine whether clients may be affected by regulations issued by the IRS and to contact these clients for the purpose of explaining the regulations and advising them about their response to the regulations. However, preparer B may not use the tax return information of taxpayers who have specifically informed B that they do not wish to be contacted by B or will not be using B's services in the upcoming filing season.

The last three scenarios, concern tax return preparers who provide monthly newsletters to clients containing educational tax information, tax tips, tax law updates, and solicitations for the preparer's tax return preparation business. The tax return preparers use third-party service providers to publish, distribute, or perform all aspects of this client communication activity. The tax return preparers provide lists to the third-party service provider that contain client names, addresses, and e-mail addresses. These preparers all have procedures in place that are designed to maintain the confidentiality of tax return information.

The third-party service provider holds itself out as providing services that are auxiliary to tax return preparation which are intended to offer additional tax information and services to the preparers' clients. Such information and additional services to clients are specifically allowed by Treas. Reg. §301-7216-2(n). The tax return preparers have procedures in place that are consistent with good business practices and designed to maintain client confidentiality. By following these procedures, the preparers conclude that the third-party service provider has sufficient data confidentiality procedures in place; therefore, the third-party service provider qualifies as both an auxiliary service provider and a tax return preparer under Treas. Reg. §301.7216-1(b)(2)(i)(B). Tax return preparers may disclose to auxiliary service providers, without obtaining taxpayer consent, tax return information to the extent necessary to obtain auxiliary services, if the service provider is located in the United States and the services provided are not substantive determinations or advice which affects the tax liability reported by the taxpayers. Thus, the third-party service provider may use the names and mailing or e-mail addresses disclosed to it to provide newsletters, or similar communications, to the tax return preparers' clients.

Disclosure

Rev. Rul. 2010-5, IRB 2010-4 (Jan. 4, 2010)
IRC §§6713 and 7216

☞ Disclosure of Information to Professional Liability Insurance Carriers Allowed

Purpose. This revenue ruling provides guidance on whether a tax return preparer is liable for penalties under IRC §§7216 and 6713 when the preparer discloses tax return information to professional liability insurance carriers.

Analysis. Tax return preparer A expects to disclose tax return information in 2010 to insurance agents or insurance company representatives in order to obtain or maintain professional liability insurance coverage. The information would include a list of client names and descriptions of the services that A provided to those clients in previous years. Preparer A also expects to disclose tax return information required by the terms of the insurance policy to report, and to aid in the investigation of, a claim or potential claim against A. This information provided to the professional liability insurance carrier may include copies of tax returns relevant to the claim or potential claim. Preparer A also expects to disclose information required by the terms of the insurance policy for the purpose of obtaining legal representation provided by the insurance carrier related to a claim or potential claim of professional negligence, misconduct, or fraud.

The professional liability insurance policy purchased by preparer A is an auxiliary service provided in connection with the preparation of tax returns. Under Treas. Reg. §301.7216-2(d)(1), preparer A may disclose to these insurance carriers, without obtaining taxpayer consent, the information required to obtain and maintain the auxiliary services of the insurance carriers. However, disclosure by a tax return preparer of tax return information beyond what is necessary to obtain or maintain insurance coverage constitutes a violation of IRC §§7216 and 6713. This would result in the tax return preparer's liability for penalties under those Code sections.

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A professional liability insurance carrier provides services which include investigation and management of claims or potential claims arising from the preparation of tax returns by the insured tax return preparer. Disclosure of tax return information in connection with these services is necessary to allow A to obtain the services of its professional liability insurance carrier. Thus, disclosure is permitted without taxpayer consent under §301.7216-2(d)(1), if the information is necessary to obtain those services. Disclosure of tax return information beyond that necessary to obtain the auxiliary services constitutes a violation of §§7216 and 6713 and would result in the tax return preparer's liability for penalties under those sections.

The terms of a professional liability insurance policy issued in connection with the preparation of tax returns typically includes the selection and engagement of an attorney to represent the preparer during a claim investigation or litigation related to a claim. Preparer A may disclose relevant tax return information, without taxpayer consent, to the insurance carrier as an auxiliary service provider under §301.7216-2(d)(1). Information disclosed which is beyond the scope of the legal representation constitutes a violation of §§7216 and 6713 and would result in the tax return preparer's liability for penalties under those sections. After the insurance carrier selects an attorney to represent preparer A in relation to the claim, A may disclose relevant tax return information to that attorney without taxpayer consent.[23]

PARTNERSHIPS

Abandonment Loss Deduction

***Jeffrey C. and Renee M. Milton v. Comm'r,* TC Memo 2009-246 (Oct. 28, 2009)**

IRC §§165, 6662, and 6664

☞ Abandonment Loss Deduction for Partnership Interest Disallowed

Facts. Renee Milton was the president and sole shareholder of RMI, a real estate business. In 2004, Ms. Milton's handyman told her about a business opportunity involving his son, Donald Purscelley, a welder for Kearney Mesa Welding (KM Welding). Mr. Purscelley was interested in purchasing the business from the owner of KM Welding, who was considering retirement. Mr. Purscelley did not have the funds to purchase KM Welding on his own, so his father asked Ms. Milton if she would be interested in participating in the purchase. Ms. Milton responded that she was interested in obtaining the right of first refusal to purchase the leased property on which KM Welding operated.

Ms. Milton gave Mr. Purscelley's father a check payable to the owner of KM Welding for $90,000 and told the father to purchase KM Welding. She used money that she had earned from RMI to fund the transaction. Ms. Milton's purchase check was dated February 17, 2004, and is the only document memorializing the transaction. Her name was not on the property lease and her rights were never put in writing.

Ms. Milton discussed forming a business entity with Mr. Purscelley and his father, with ownership of the business to be divided into thirds among her, Mr. Purscelley, and his father. Mr. Purscelley created an LLC but dissolved it in 2005 and operated KM Welding as a sole proprietorship during 2005.

In 2005, Ms. Milton became concerned that KM Welding was not paying its bills or completing projects. She was worried that her connection with KM Welding would harm her reputation and affect RMI's financial health. Ms. Milton's CPA advised her that it would be in her best interests to abandon the KM Welding partnership interest rather than risk her reputation and RMI.

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23. Treas. Reg. §301.7216-2(g)(1).

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RMI claimed a $100,000 abandonment loss on its 2005 Form 1120S that passed through to Ms. Milton as the sole shareholder. Although the loss was identified as an abandonment of a partnership interest, RMI's 2005 balance sheet did not list a partnership interest as of the beginning of the year.

The IRS issued a deficiency notice to Ms. Milton and her husband, disallowing the abandonment loss and adjusting Ms. Milton's distributive share from RMI. The IRS assessed additional tax in the amount of $86,767 and a $17,353 accuracy-related penalty under IRC §6662(a).

Issues. Whether Ms. Milton underreported her distributive share from RMI for 2005 and whether she is liable for an accuracy-related penalty.

Analysis. In order to claim an abandonment loss deduction, a taxpayer must prove she owned the property abandoned. Ms. Milton did not prove that RMI owned the partnership interest it purportedly abandoned in 2005. Ms. Milton did not have an asset purchase agreement or other document to substantiate the transaction; she also failed to prove that the funds involved were RMI's rather than hers individually.

Additionally, to claim an abandonment loss, the taxpayer must establish that she (1) intended to abandon the property, and (2) took affirmative action to abandon the property.[24] When the asset is an intangible property interest, such as a partnership interest, an express manifestation of abandonment is required.[25]

Ms. Milton did not provide any independent evidence to support her alleged intent to abandon the partnership interest in KM Welding. She did not offer any evidence that she would be held liable for any debts of KM Welding or that KM Welding was not completing projects or paying its bills.

Further, Ms. Milton did not take any affirmative action in 2005 to abandon the alleged partnership interest in KM Welding. She did not provide a date on which she abandoned the interest nor did she file any public document indicating that she was no longer associated with KM Welding. Additionally, there is no evidence that Ms. Milton informed her alleged partners that she was abandoning the partnership interest.

A taxpayer is liable for an accuracy-related penalty for any portion of an income tax underpayment attributable to negligence or disregard of rules and regulations unless she establishes that there is reasonable cause for the underpayment and that she acted in good faith.[26]

RMI did not maintain any books or records to substantiate the abandonment loss on its 2005 tax return. Uncorroborated self-serving testimony was the only evidence Ms. Milton presented regarding the abandonment of the alleged partnership interest. Further, Ms. Milton testified that she abandoned the KM Welding partnership interest on the advice of her CPA. However, she failed to provide even the name of her CPA or any adequate evidence that she acted in good-faith reliance on information provided by the CPA.

Holding. The court held that Ms. Milton was not entitled to an abandonment loss deduction and that she is liable for the accuracy-related penalty under §§6662(a) and (b)(1).

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24. *Citron v. Comm'r*, 97 TC 200, 208-209 (1991).

25. Ibid.

26. IRC §§6662(a) and (b)(1), 6664(c)(1).

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PASSIVE ACTIVITIES

Passive Activity Losses

***Ralph and Angela Cunningham v. Comm'r,* TC Memo 2009-194 (Aug. 31, 2009)**
IRC §§469 and 6651

☞ Losses from Horse Activities Disallowed

Facts. Ralph Cunningham was on the dental faculty at New York University and maintained a private dental practice in Peekskill, New York during 2002. The Cunninghams were residents of New York at the time the petition was filed.

The Cunninghams' joint Form 1040 for 2002 was filed on April 21, 2006. The return included a Schedule E, *Supplemental Income and Loss*, which claimed losses from five separate horse activities located in California. The Cunninghams' joint return and the partnership returns for the horse activities were prepared by Robert Gruntz.

The Cunninghams received a notice of deficiency from the IRS, wherein the losses were disallowed as passive activities under IRC §469. On the advice of Gruntz, the Cunninghams initially refused to cooperate with the IRS. They were notified on January 14, 2009, that the trial in New York was set for June 15, 2009. When the case was called for trial, the Cunninghams produced exhibits but without any narrative facts.

Issues. Whether the Cunninghams' reported losses from horse activities are limited by §469 and whether they have reasonable cause for the late filing of their return.

Analysis. Deduction of losses from passive activities is limited to income generated by such activities by §469, unless taxpayers establish that they materially participated in the activities. The Cunninghams did not show any participation in the horse activities at issue. They signed returns claiming substantial losses without determining the accuracy of the partnership returns for the horse activities.

The Cunninghams did not deny that the return was filed late. IRC §6651(a)(1) provides for penalties for failure to timely file a tax return, unless it is shown that the failure to file timely is due to reasonable cause and not due to willful neglect. The Cunninghams offered no explanation of the reasons for the late filing of their return.

In a post-trial memorandum, Ralph Cunningham asserted that he was "duped by a charlatan and in essence Robert Gruntz tacitly implied that I should fabricate a log that would show 'material participation.'" The Cunninghams stated that the liability would be a financial burden for their family and threw themselves at the mercy of the court to consider reducing the liability.

Holding. The Cunninghams were found liable for a deficiency of $11,515 and a late-filing addition of $1,056 for their 2002 federal income tax return.

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RESIDENCES

Installment Method for Sale of Residence

Ltr. Rul. 200931001 (Apr. 14, 2009)
IRC §453

☞ Taxpayers Allowed to Revoke Election Out of Installment Method

Facts. Taxpayers sold their principal residence. They received the proceeds from the sale over a 2-year period.

The taxpayers used a tax return preparer to prepare their tax return for the year their residence was sold. This preparer advised the taxpayers that the installment sale treatment could not be combined with the IRC §121 exclusion for income from the sale of a principal residence. As a result, the taxpayers reported all the gain, less the §121 exclusion, from the sale of their principal residence on their federal income tax return for the year the residence was sold.

The taxpayers changed tax return preparers two years after the sale of their residence. The new preparer advised the taxpayers that it was possible to exclude gain on the sale of a principal residence while reporting the remaining gain on the installment method. Consequently, the taxpayers requested approval to revoke the election out of the installment method for the year their principal residence was sold.

Analysis. IRC §453(a) provides that a taxpayer generally shall report income from an installment sale under the installment method. An installment sale is defined as a disposition of property for which at least one payment is to be received after the close of the taxable year of the disposition.[27]

A taxpayer may elect out of the installment method by reporting an amount realized equal to the selling price on a timely-filed tax return for the taxable year in which the installment sale occurs.[28] This election may be revoked only with the consent of the IRS.

Holding. Taxpayers are allowed to revoke their election out of the installment method for the sale of their principal residence.

RETIREMENT

Early Distribution Penalty

***Eugene and Glenda Dollander v. Comm'r,* TC Memo 2009-187 (Aug. 19, 2009)**
IRC §§72(t) and 6662

☞ Hardship Withdrawal Not Exempt from Early Withdrawal Penalty

Facts. Eugene Dollander worked for the Department of Veterans Affairs (VA) from June 1985 to April 2006. In 2004, he worked at the VA medical center in Augusta, Georgia, as a nurse in the triage section, which dealt with evaluating individuals having psychiatric emergencies.

On June 30, 2004, Dollander evaluated a person who died within an hour thereafter. Because of this incident, Dollander was reassigned to a clerical position and began to suffer mental health difficulties.

In October 2004, Dollander was diagnosed with post-traumatic stress disorder, depressive disorder, and bipolar type II. He began psychotherapy sessions and was restricted to light duty.

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27. IRC §453(b)(1).

28. Treas. Reg. §15A.453-1(d)(3).

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Dollander struggled with the VA during this period. He was accused of not performing his duties adequately. He was suspended from work without pay in February 2005. At the end of his suspension period, Dollander was taken off light duty and transferred to a job in a locked psychiatric unit in Minnesota.

While employed with the VA, Dollander established a thrift savings plan. In 2005, he requested and received an in-service financial hardship distribution of $158,310.

In April 2006, Dollander retired from the VA. His retirement was under the disability classification with the Federal Employee Retirement System. Approximately one month after he retired from the VA, Dollander began full-time work as a nurse with the State of Georgia Community Services Board.

Subsequently, the IRS assessed a deficiency in the Dollanders' 2005 income tax of $16,918 and an accuracy-related penalty of $3,384.

Issues. Whether the Dollanders are liable for the 10% additional tax under IRC §72(t) for an early distribution from a qualified retirement plan and whether they are liable for the IRC §6662(a) accuracy-related penalty.

Analysis. IRC §72(t)(1) imposes a 10% additional tax on any distribution from a qualified retirement plan that does not satisfy one of the exceptions in §72(t)(2). The thrift savings plan is a qualified retirement plan, and Dollander's 2005 distribution of $158,310 was made before he attained age 59½. Thus, the 10% additional tax applies to the distribution unless an exception applies.

Dollander contended that he should not be subject to the 10% additional tax because he requested and received a financial hardship in-service withdrawal. However, financial hardship is not one of the exceptions listed in §72(t)(2).

Dollander further maintained that he received the distribution because he was disabled and that distributions from a qualified retirement plan attributable to the employee's disability are excepted from the 10% penalty. IRC §72(m)(7) defines an individual as being disabled for purposes of §72 as follows: "… he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration."

In 2005, Dollander continued working at the VA earning the same salary as before his impairment was diagnosed. He then retired from the VA in 2006 and got a full-time job with another employer. Thus, Dollander was not disabled for purposes of §72(t)(2).

The accuracy-related penalty under §6662(a) does not apply to any part of an underpayment of tax if it is shown that the taxpayer acted with reasonable cause and in good faith.[29] H&R Block prepared the Dollanders' 2005 tax return. The Dollanders apparently were forthright with information they gave to H&R Block, including providing the receipt for the $158,310 distribution from the thrift saving plan.

Holding. Dollander was held liable for the 10% early-withdrawal penalty because he did not qualify for an exception under §72(t). The Dollanders were not charged with the §6662(a) penalty for the underpayment relating to the 10% additional tax because they acted in good faith and with reasonable cause.

29. IRC §6664(c)(1).

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Retirement Plan Distributions

***Kenneth L. Graham v. Comm'r,* TC Summ. Op. 2009-139 (Sept. 8, 2009)**

IRC §72(t)

☞ IRA Distributions Not Substantially Equal Periodic Payments

Facts. Kenneth Graham retired in 1999 after 35 years of employment with a telephone company. At the time of his retirement, he elected to receive a lump-sum distribution of a pension that he accumulated during his employment with the telephone company. Graham rolled these funds over into several self-directed IRAs.

Graham began receiving periodic distributions from his IRAs in 1999 at age 51. His financial advisors determined the amount of Graham's distributions from his IRAs but did not provide him with documentation detailing how the distribution amounts were calculated. Graham's advisors told him that the distributions were in accordance with one of the exceptions under IRC §72(t)(2).

In 2006, when Graham was 58, he received a total of $61,833 in distributions from four IRAs. The combined value of the IRAs at the close of the 2006 tax year was $284,372.

Graham reported the distributions as income on his 2006 federal income tax return but did not report any additional tax on these distributions. The IRS subsequently notified him that the distributions were subject to the 10% additional tax under §72(t). Graham argued that the distributions were part of a series of substantially equal periodic payments and, accordingly, were not subject to the additional tax.

Issues. Whether Graham is liable for the 10% additional tax on early distributions from qualified retirement plans under §72(t)(1).

Analysis. IRC §72(t)(1) imposes a 10% additional tax on early distributions from qualified retirement plans. This 10% additional tax does not apply to distributions that are part of a series of substantially equal payments made not less frequently than annually over the life (or life expectancy) of the employee.

Payments are considered substantially equal periodic payments if the amount of the payments is determined by one of three methods:

- The required minimum distribution method,
- The fixed amortization method, or
- The fixed annuitization method.[30]

Each of these three methods takes the taxpayer's life expectancy into consideration.

Graham had a life expectancy of 27.0 years in 2006. The amount distributed to him in that year, $61,833, exceeds one-sixth of the total value of his IRAs at the beginning of 2006. If he continued to receive distributions at that rate, his IRA balances would be depleted within seven years. Thus, the distributions could not possibly be substantially equal periodic payments made over Graham's life expectancy.

Holding. Graham is liable for the 10% additional tax under §72(t).

30. See Rev. Rul. 2002-62, 2002-2 CB 710 .

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401(k) Plan Enrollment

IRS Notice 2009-65, IRB 2009-39 (Sept. 28, 2009)
IRC §§401(k) and 414

☞ Sample Amendments for Adding 401(k) Automatic Enrollment Features

Purpose. This notice provides two sample plan amendments for employers and sponsors who want to add certain automatic enrollment features to their 401(k) plans.

Analysis. In the absence of an employee's affirmative election, a default provision can be applied under which the employer makes elective contributions to a 401(k) plan on the employee's behalf.[31]

401(k) plan sponsors who want to add one of the sample amendments providing for automatic enrollment to their plans must adopt the amendment by the later of (1) the end of the plan year in which the amendment is effective, or (2) the deadline under section 1107 of the Pension Protection Act of 2006, if applicable. Proper notice must be provided to affected employees that describes the features of the plan as amended.

The adoption of either sample plan amendment (as modified, if necessary) will not result in the loss of reliance on a favorable opinion, advisory, or determination letter.

SIMPLE IRA Enrollment

IRS Notice 2009-67, IRB 2009-39 (Sept. 28, 2009)
IRC §408

☞ Sample Plan Amendment for Automatic Enrollment in SIMPLE IRA Plans

Purpose. This notice provides a sample plan amendment that prototype sponsors of SIMPLE IRA plans can use in drafting an amendment to add an automatic contribution feature to their plans. Only those plans using a designated financial institution described in IRC §408(p)(7) can use the sample amendment.

Analysis. Under an automatic contribution arrangement, in the absence of an affirmative elective by an employee, a default election applies which provides that the employee is treated as having elected to have a portion of the employee's compensation contributed to a qualified retirement plan.

An employer that wants to add an automatic contribution feature to its prototype SIMPLE IRA plan using a designated financial institution must adopt an amendment provided by the prototype sponsor before the effective date of the automatic contribution arrangement. The adoption of the amendment must be evidenced by a written document that is signed and dated by the employer and designated financial institution.

Retirement Plans

IRS Notice 2009-82, IRB 2009-41 (Oct. 13, 2009)
IRC §§401, 403, and 408

☞ IRS Issues Guidance on 2009 RMD Waiver

Purpose. This notice provides guidance relating to the 2009 waiver of required minimum distributions (RMDs) from certain plans. The 2009 RMD waiver was implemented as part of the Worker, Retiree, and Employer Recovery Act of 2008. This notice also provides guidance to plan sponsors about the treatment of waived RMDs and certain related payments.

31. Treas. Reg. §1.401(k)-1(a)(3)(ii).

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Analysis. Plan participants and IRA owners who have already received RMDs in 2009 have until the later of 60 days after the distribution was received or November 30, 2009, to roll over the distribution. However, no more than one distribution from an IRA in 2009 is eligible for the rollover relief.

The Appendix to this notice contains two alternative sample plan amendments that plan sponsors can adopt or use in drafting individualized plan amendments. These sample amendments provide participants and beneficiaries with the choice to receive or not receive distributions of 2009 RMDs.

> **Note.** For more information on the 2009 waiver of RMDs, see the Retirement and New Legislation chapters of the 2009 *University of Illinois Federal Tax Workbook.*

Retirement Plan Contributions

Rev. Rul. 2009-31, IRB 2009-39 (Sept. 5, 2009)
IRC §§401, 402, 415, 451, and 409A

☞ Annual Contributions of Unused Paid Time Off to Retirement Plan Allowed

Purpose. This revenue ruling provides guidance on the tax consequences of an amendment to a qualified retirement plan to permit contributions of an employee's unused paid time off.

Analysis. In the first scenario presented, Company Z maintains a paid time-off plan (PTO plan) as well as a profit-sharing plan. The company amended the plans in December 2008 to specify that the dollar amount of unused paid time off as of the end of the year was forfeited and contributed to the profit-sharing plan of the employee. In the event that these contributions, in combination with prior additions, exceeded the IRC §415(c) limitations, the dollar equivalent of any remaining paid time off is paid to the employee by February 28 of the following year. The amounts attributable to paid time off are treated as nonelective contributions to the profit-sharing plan.

The facts presented in the first scenario do not cause the profit sharing plan of Company Z to fail to meet the requirements of IRC §401(a), if all the contributions made under the arrangement satisfy the nondiscrimination requirements of §401(a)(4). The dollar equivalent of any remaining paid time off which is paid to the employee is includible in the employee's gross income in the taxable year in which it is paid.

In the second scenario presented, Company Y maintains both a profit-sharing plan and a PTO plan, under which employees may carry over to the next year a specified number of hours of unused paid time off. The dollar equivalent of any unused paid time off in excess of the carryover limit is paid to the employee by February 28 of the following year.

Company Y amended its 401(k) plan and its PTO plan in December 2008 to provide that a participant may elect to reduce all or a part of any unused paid time off that exceeds the carryover limit and have the dollar equivalent of that time off contributed by the Company to the participant's 401(k) account. Under the terms of the Company Y 401(k) plan, contributions of the dollar equivalent of paid time off are treated as elective contributions. The dollar equivalent of any unused paid time off that is not contributed to the 401(k) plan is paid to the participant by February 28 of the following year.

The amendment of the 401(k) plan of Company Y does not cause the plan to fail to meet the requirements of §§401(a) and 401(k), if the contributions satisfy the nondiscrimination requirements and applicable limitations. Such contributions are elective and are taken into consideration for the nondiscrimination requirements and applicable limitations for the year in which they are made. Likewise, the dollar equivalent of any unused paid time off that is paid to the participant is includible in the participant's gross income in the taxable year in which it is paid.

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Retirement Plan Contributions

Rev. Rul. 2009-32, IRB 2009-39 (Sept. 5, 2009)
IRC §§401, 402, 415, 409A, and 451

☞ Unused Paid Time Off Can be Contributed to Plan at Termination of Employment

Purpose. This revenue ruling provides guidance on the tax consequences of various amendments to profit-sharing plans which require or permit contributions to the plan of the dollar equivalent of unused paid time off at the termination of employment.

Analysis. Several scenarios are presented in this revenue ruling in which the dollar equivalent of unused paid time off is contributed to a profit-sharing plan. In one of the scenarios, the profit-sharing plan is amended to specify that the dollar equivalent of unused paid time off at the termination of a participant's employment is contributed to the company profit-sharing plan and allocated to the participant's account. The dollar equivalent of any unused paid time off that is not contributed to the profit-sharing plan is paid to the terminated participant within 60 days after termination. In another scenario, a 401(k) plan is amended to provide that a participant may elect to have the dollar equivalent of all or a portion of any unused paid time off contributed to the participant's 401(k) account at the time the participant's employment is terminated. The dollar equivalent of any unused paid time off that is not contributed to the 401(k) plan is paid to the employee after termination of employment.

In each of the scenarios presented, the amendments to the qualified retirement plans did not cause the plans to fail to meet the requirements of IRC §§401(a) and/or 401(k), nor to exceed the limitations of IRC §415(c). Additionally, the IRS affirmed that the dollar equivalent of unused paid time off paid to the participant is includible in the participant's gross income in the year in which it is received.

TRAVEL AND TRANSPORTATION EXPENSE

Travel Expenses

Rev. Proc. 2009-47, 2009-42 IRB (Sept. 30, 2009)
IRC §§162, 274, and 62

☞ New Per Diem Rates for post-September 30, 2009 Travel

Purpose. This revenue procedure updates the federal per diem rate and federal meal and incidental expense (M&IE) rate.

Analysis. The per diem rate is $258 (a $2 increase) for travel to any "high-cost" locality, or $163 (a $5 increase) for travel to any other locality within the continental United States (CONUS). The amount of the high and low rates that is treated as paid for meals is $65 and $52, respectively.

For CONUS travel, a payor reimbursing an employee using the actual per diem method for the first nine months of 2009 cannot switch to the high-low per diem method for that employee until the beginning of 2010. Similarly, a payor using the high-low method to reimburse an employee for the first nine months of 2009 must continue using that method to reimburse that employee for the remainder of 2009. However, the payor may continue to use the high-low rates previously in effect for the remainder of 2009. There is no requirement to switch to the new rates for the last three months of the year.

Transportation industry workers may treat $59 as the federal M&IE rate for any CONUS travel locality and $65 as the M&IE rate for any locality outside the continental United States (OCONUS).

> **Note.** See page 49 in this supplement for the 2010 auto standard mileage allowance rates.

Effective Date. For travel on or after October 1, 2009

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Please note. Corrections for all of the chapters are available at **www.TaxSchool.illinois.edu.** For clarification about acronyms used throughout this chapter, see the Acronym Glossary at the end of the Index.

INFLATION ADJUSTED ITEMS AND OTHER USEFUL INFORMATION

	2009	2010
Standard Deductions		
Joint or Qualifying Widow(er)	$ 11,400	$ 11,400
Single	5,700	5,700
Head of Household	8,350	8,400
Married Filing Separately	5,700	5,700
Additional for Elderly/Blind — MFJ, MFS, QW	1,100	1,100
Additional for Elderly/Blind — Single, HoH	1,400	1,400
Taxpayer Claimed as Dependent	950	950
Personal and Dependent Exemption Deduction	3,650	3,650
Long-Term Care Premiums		
Age 40 or less	320	330
Age more than 40 but not more than 50	600	620
Age more than 50 but not more than 60	1,190	1,230
Age more than 60 but not more than 70	3,180	3,290
Age more than 70	3,980	4,110
Child's Unearned Income Without Kiddie Tax	1,900	1,900
Beginning/Ending of Personal Exemption Phaseout Range — Based on AGI		
Joint or Qualifying Widow(er)	250,200 / 372,700	Not available
Single	166,800 / 289,300	Not available
Head of Household	208,500 / 331,000	Not available
Married Filing Separately	125,100 / 186,350	Not available
IRC §179 Deduction Limit	250,000	134,000
IRC §179 Asset Limitation	800,000	530,000

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	2009	2010
Beginning/Ending of Itemized Deduction Phaseout Range — Based on AGI		
Joint, Single, Head of Household	$166,800	Not available
Married Filing Separately	83,400	Not available
FICA/SE Tax Information		
OASDI Tax Maximum Earnings	106,800	106,800
FICA (OASDI and HI) Tax Rate (Employee)	7.65%	7.65%
SE Tax Rate	15.30%	15.30%
Self-Employed Health Insurance Deduction	100%	100%
Estimated Tax Payments (AGI $\leq$ $150,000)		
Prior Year Tax % or	100%	100%
Current Year Tax %	90%	90%
Earnings Ceiling for Social Security		
Under full retirement age	14,160	14,160
The year full retirement age is reached	37,680	37,680
The month full retirement age is reached, and above	Unlimited	Unlimited
Earnings Required to Earn One Quarter of Social Security Coverage	1,090	1,120
Gift Tax Applicable Exclusion Amount	1,000,000	Not available
Estate Tax Applicable Exclusion Amount	3,500,000	Not available
Maximum Gift	13,000	13,000
Capital Gain Rates (Maximum for Noncorporate Taxpayers)		
Adjusted Net Capital Gain (Assets held more than 12 months)	15%	15%
For those in 15% bracket	0%	0%
For those in >15% bracket	15%	15%
For Recapture Gain on Real Estate	25%	25%
For Most Collectibles	28%	28%
Adoption Credit		
Special Needs Child	12,150	12,170
Other Children	12,150	12,170
Phaseout Amount	182,180 / 222,180	182,520 / 222,520

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	2009	2010
Lifetime Learning Credits		
Phaseout — Single, HoH, QW	50,000– 60,000	50,000– 60,000
Phaseout — MFJ	100,000–120,000	100,000–120,000
Hope/American Opportunity Credit		
Phaseout — Single, HoH, QW	80,000– 90,000	80,000– 90,000
Phaseout — MFJ	160,000–180,000	160,000–180,000
Earned Income Tax Credit		
One child		
Minimum earned income for maximum EITC	8,950	8,970
Maximum Amount of Credit	3,043	3,050
Phaseout Amount (single and head of household)	16,420 / 35,463	16,450 / 35,535
Phaseout Amount (married filing jointly)	19,540 / 38,583	21,460 / 40,545
Two Children		
Minimum earned income for maximum EITC	12,570	12,590
Maximum Amount of Credit	5,028	5,036
Phaseout Amount (single and head of household)	16,420 / 40,295	16,450 / 40,363
Phaseout Amount (married filing jointly)	19,540 / 43,415	21,460 / 45,373
Three or More Children		
Minimum earned income for maximum EITC	12,570	12,590
Maximum Amount of Credit	5,657	5,666
Phaseout Amount (single and ehad of household)	16,420 / 43,279	16,450 / 43,352
Phaseout Amount (married filing jointly)	21,420 / 43,279	21,460 / 48,362
No children		
Minimum earned income for maximum EITC	5,970	5,980
Maximum Amount of Credit	457	457
Phaseout Amount (single and head of household)	7,470 / 13,440	7,480 / 13,460
Phaseout Amount (married filing jointly)	10,590 / 16,560	12,490 / 18,470
Child Tax Credit	1,000	1,000

Daycare Provider
Standard Meal Allowance for 2009 Returns
July 1, 2008 through June 30, 2009

	48 States	Alaska	Hawaii
Breakfast	$1.17	$1.86	$1.36
Lunch/Dinner	2.18	3.53	2.55
Snack	.65	1.05	.76

Daycare Provider
Standard Meal Allowance for 2010 Returns
July 1, 2009 through June 30, 2010

	48 States	Alaska	Hawaii
Breakfast	$1.19	$1.89	$1.38
Lunch/Dinner	2.21	3.59	2.59
Snack	.66	1.07	.77

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Child Tax Credit AGI Phaseout — 2009

Filing Status	Beginning Phaseout
MFJ	$110,000
Single, HOH, QW	75,000
MFS	55,000

M&IE (Meals-and-Incidental-Expense-Only) Rates for Transportation Workers for Travel Away from Home

	On or Before Sep. 30, 2009	Oct. 1–Dec. 31, 2009
CONUS (continental United States) localities	$52	$59
OCONUS (outside the continental United States) localities	58	65

High and Low Per Diem Reimbursements

	On or Before Sep. 30, 2009	On or After Oct. 1, 2009
High cost areas	$256 ($58 for M&IE)	$258 ($65 for M&IE)
Basic/low cost areas	$158 ($45 for M&IE)	$163 ($52 for M&IE)

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DEPRECIATION LIMITS FOR LUXURY VEHICLES[1]

Tax Year	Used Passenger Vehicles	New Passenger Vehicles	Used Trucks and Vans	New Trucks and Vans	Used Electric Vehicles	New Electric Vehicles
Placed in service in 2009						
1	$2,960	$ 2,960 [a]	$ 3,060	$ 3,060 [a]		
2	4,800	4,800	4,900	4,900	[b]	[b]
3	2,850	2,850	2,950	2,950		
4	1,775	1,775	1,775	1,775		
Placed in service in 2008						
1	$2,960	$ 2,960 [a]	$ 3,160	$ 3,160 [a]		
2	4,800	4,800	5,100	5,100	[b]	[b]
3	2,850	2,850	3,050	3,050		
4 or more	1,775	1,775	1,875	1,875		
Placed in service in 2007						
1	$3,060	$ 3,060	$ 3,260	$ 3,260		
2	4,900	4,900	5,200	5,200	[b]	[b]
3	2,850	2,850	3,050	3,050		
4 or more	1,775	1,775	1,875	1,875		
Placed in service in 2006						
1	$2,960	$ 2,960	$3,260	$ 3,260	$ 8,980	$ 8,980
2	4,800	4,800	5,200	5,200	14,400	14,400
3	2,850	2,850	3,150	3,150	8,650	8,650
4 or more	1,775	1,775	1,875	1,875	5,225	5,225
Placed in service in 2005						
1	$2,960	$ 2,960	$3,260	$ 3,260	$ 8,880	$ 8,880
2	4,700	4,700	5,200	5,200	14,200	14,200
3	2,850	2,850	3,150	3,150	8,450	8,450
4 or more	1,675	1,675	1,875	1,875	5,125	5,125
Placed in service in 2004						
1	$2,960	$10,610	$3,260	$10,910	$ 8,880	$31,830
2	4,800	4,800	5,300	5,300	14,300	14,300
3	2,850	2,850	3,150	3,150	8,550	8,550
4 or more	1,675	1,675	1,875	1,875	5,125	5,125
Placed in service after May 5, 2003 and before January 1, 2004						
1	$3,060	$10,710	$3,360	$11,010	$ 9,080	$32,030
2	4,900	4,900	5,400	5,400	14,600	14,600
3	2,950	2,950	3,250	3,250	8,750	8,750
4 or more	1,775	1,775	1,975	1,975	5,225	5,225

[a] For 2008 and 2009, 50% bonus depreciation is available for new vehicles placed in service. The maximum first-year depreciation for new passenger vehicles is $10,960 for 2008 and 2009. The maximum first-year depreciation for new trucks and vans is $11,160 for 2008 and $11,060 for 2009.

[b] New and used electric vehicles placed in service after December 31, 2006 do not have special depreciation limits; use the appropriate column to the left.

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1. Rev. Procs. 2006-18, 2007-11, and 2009-24

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NET OPERATING LOSS CARRYBACK

	NOLs 2000 and Before	NOLs in 2001 and 2002	NOLs 2003–2007	NOLs in 2008–2009
Regular NOL	2 years [a]	5 years, but may elect 2 years	2 years [a]	2 years, but may elect 3, 4, or 5 years
Eligible Loss NOL	3 years	5 years, but may elect 3 years	3 years	3 years
Farm Loss NOL	5 years, but may elect 2 years	5 years, but may elect 2 years	5 years, but may elect 2 years	5 years, but may elect 2 years

[a] Extended to 5 years for certain federally-declared disaster areas.

NOTE: NOLs for tax years beginning before August 6, 1997 are carried forward 15 years. Any subsequent NOL is carried forward 20 years.

SAVER'S CREDIT PHASEOUT — 2010

	AGI Phaseout		
Credit Rate	MFJ	HOH	Single, MFS, QW
50%	$ 0–33,500	$ 0–25,125	$ 0–16,750
20%	33,501–36,000	25,126–27,000	16,751–18,000
10%	36,001–55,500	27,001–41,625	18,001–27,750
0%	Over $55,500	Over $41,625	Over $27,750

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QUALIFIED RETIREMENT PLAN LIMITATIONS

	2009	2010
Contributions/Deferrals		
Maximum deductible employee annual retirement contribution **(401(k), 403(b), 457, SARSEP, Thrift Savings Plans)**	$ 16,500	$ 16,500
Catch-up contributions (age 50 or over)	5,500	5,500
Maximum annual deferral under **SIMPLE**	11,500	11,500
Catch-up deferral (age 50 or over)	2,500	2,500
Maximum **traditional and Roth IRA** annual contributions (the annual limit is lesser of 100% of taxable compensation or listed amount)	5,000	5,000
Catch-up contributions (age 50 or over)	1,000	1,000
Catch-up for certain 401(k) participants whose employer filed for bankruptcy	3,000	3,000
Maximum employer contribution to **SEP IRA** (the annual limit is lesser of 25% of compensation or listed amount)	49,000	49,000
Income limitations		
Maximum annual benefit for a **defined benefit plan** (based on annual compensation, the annual limits may be less) [a]	195,000	195,000
Maximum annual contribution to **all defined contribution plans** (the annual limit is lesser of 100% of compensation or listed amount)	49,000	49,000
Earnings threshold for **highly-compensated employees**	110,000	110,000
Earnings threshold for **key employee in top-heavy plan**	160,000	160,000

[a] Treas. Reg. §1.415(b)-1 and IRC §415(b)

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UNIFORM LIFETIME TABLE/SINGLE LIFE EXPECTANCY TABLE

This chart combines the *Uniform Lifetime Table* and the *Single Life Expectancy Table* found in IRS Pub. 590, *Individual Retirement Arrangements.*

Age	Single Life	Uniform Life	Age	Single Life	Uniform Life	Age	Single Life	Uniform Life	Age	Single Life	Uniform Life
10	72.8	86.2	34	49.4	62.3	58	27.0	38.7	82	9.1	17.1
11	71.8	85.2	35	48.5	61.4	59	26.1	37.8	83	8.6	16.3
12	70.8	84.2	36	47.5	60.4	60	25.2	36.8	84	8.1	15.5
13	69.9	83.2	37	46.5	59.4	61	24.4	35.8	85	7.6	14.8
14	68.9	82.2	38	45.6	58.4	62	23.5	34.9	86	7.1	14.1
15	67.9	81.2	39	44.6	57.4	63	22.7	33.9	87	6.7	13.4
16	66.9	80.2	40	43.6	56.4	64	21.8	33.0	88	6.3	12.7
17	66.0	79.2	41	42.7	55.4	65	21.0	32.0	89	5.9	12.0
18	65.0	78.2	42	41.7	54.4	66	20.2	31.1	90	5.5	11.4
19	64.0	77.3	43	40.7	53.4	67	19.4	30.2	91	5.2	10.8
20	63.0	76.3	44	39.8	52.4	68	18.6	29.2	92	4.9	10.2
21	62.1	75.3	45	38.8	51.5	69	17.8	28.3	93	4.6	9.6
22	61.1	74.3	46	37.9	50.5	70	17.0	27.4	94	4.3	9.1
23	60.1	73.3	47	37.0	49.5	71	16.3	26.5	95	4.1	8.6
24	59.1	72.3	48	36.0	48.5	72	15.5	25.6	96	3.8	8.1
25	58.2	71.3	49	35.1	47.5	73	14.8	24.7	97	3.6	7.6
26	57.2	70.3	50	34.2	46.5	74	14.1	23.8	98	3.4	7.1
27	56.2	69.3	51	33.3	45.5	75	13.4	22.9	99	3.1	6.7
28	55.3	68.3	52	32.3	44.6	76	12.7	22.0	100	2.9	6.3
29	54.3	67.3	53	31.4	43.6	77	12.1	21.2	101	2.7	5.9
30	53.3	66.3	54	30.5	42.6	78	11.4	20.3	102	2.5	5.5
31	52.4	65.3	55	29.6	41.6	79	10.8	19.5	103	2.3	5.2
32	51.4	64.3	56	28.7	40.7	80	10.2	18.7	104	2.1	4.9
33	50.4	63.3	57	27.9	39.7	81	9.7	17.9	105	1.9	4.5

Column 1: Age refers to either the owner while living or the beneficiary after owner's death.

Column 2: Single Life is used for a beneficiary.

Column 3: Uniform Life is used by owner before death.

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OTHER RATES FOR VEHICLES

	Jan. 1–Jun. 30 2008	Jul. 1–Dec. 31 2008	Jan. 1–Feb. 28 2009	Mar. 1–Dec. 31 2009	2010
Auto Standard Mileage Allowance					
Business	$0.505	$0.585	$0.55	$0.55	$0.50
Charity work	0.14	0.14	0.14	0.14	0.14
Medical/moving	0.19	0.27	0.24	0.24	0.165
Qualified Transportation Fringe (expressed as monthly limits)					
Vehicle/transit pass limit	$ 115	$ 115	$ 120	$ 230	$ 230
Qualified parking limit	220	220	230	230	230
Qualified bicycle limit			20	20	20

TAX RATES FOR 2010

Tax Rate Schedule
Single Taxpayers
For Tax Years Beginning in 2010

If Taxable Income Is			
Over	But Not Over	The Tax Is	Of the Amount Over
$ 0	$ 8,375	10.0%	$ 0
8,375	34,000	837.50 + 15.0%	8,375
34,000	82,400	4,681.25 + 25.0%	34,000
82,400	171,850	16,781.25 + 28.0%	82,400
171,850	373,650	41,827.25 + 33.0%	171,850
373,650		108,421.25 + 35.0%	373,650

Tax Rate Schedule
Married Individuals Filing Joint Returns and Surviving Spouses
For Tax Years Beginning in 2010

If Taxable Income Is			
Over	But Not Over	The Tax Is	Of the Amount Over
$ 0	$ 16,750	10.0%	$ 0
16,750	68,000	1,675.00 + 15.0%	16,750
68,000	137,300	9,362.50 + 25.0%	68,000
137,300	209,250	26,687.50 + 28.0%	137,300
209,250	373,650	46,833.50 + 33.0%	209,250
373,650		101,085.50 + 35.0%	373,650

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Tax Rate Schedule
Married Individuals Filing Separate Returns
For Tax Years Beginning in 2010

If Taxable Income Is			
Over	But Not Over	The Tax Is	Of the Amount Over
$ 0	$ 8,375	10.0%	$ 0
8,375	34,000	837.50 + 15.0%	8,375
34,000	68,650	4,681.50 + 25.0%	34,000
68,650	104,625	13,343.75 + 28.0%	68,650
104,625	186,825	23,416.75 + 33.0%	104,625
186,825		50,542.75 + 35.0%	186,825

Tax Rate Schedule
Head of Household
For Tax Years Beginning in 2010

If Taxable Income Is			
Over	But Not Over	The Tax Is	Of the Amount Over
$ 0	$ 11,950	10.0%	$ 0
11,950	45,500	1,195.00 + 15.0%	11,950
45,550	117,650	6,235.00 + 25.0%	45,550
117,650	190,550	24,260.00 + 28.0%	117,650
190,550	373,650	44,672.00 + 33.0%	190,550
373,650		105,095.00 + 35.0%	373,650

Tax Rate Schedule
Trusts and Estates
For Tax Years Beginning in 2010

If Taxable Income Is			
Over	But Not Over	The Tax Is	Of the Amount Over
$ 0	$2,300	15.0%	$ 0
2,300	5,350	345.00 + 25.0%	2,300
5,350	8,200	1,107.50 + 28.0%	5,350
8,200	11,200	1,905.50 + 33.0%	8,200
11,200		2,895.50 + 35.0%	11,200

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Tax Rate Schedule
Corporate
For Tax Years Beginning in 2009

If Taxable Income Is Over	But Not Over	The Tax Is	Of the Amount Over
$ 0	$ 50,000	15.0%	$ 0
50,000	75,000	7,500.00 + 25.0%	50,000
75,000	100,000	13,750.00 + 34.0%	75,000
100,000	335,000	22,250.00 + 39.0%	100,000
335,000	10,000,000	113,900.00 + 34.0%	335,000
10,000,000	15,000,000	3,400,000.00 + 35.0%	10,000,000
15,000,000	18,333,333	5,150,000.00 + 38.0%	15,000,000
18,333,333		6,416,667.00 + 35.0%	18,333,333

FEDERAL LAND BANK INTEREST RATES FOR VALUING FARMLAND UNDER SPECIAL USE VALUATION RULES OF IRC §2032A[2]

Farm Credit Bank District in Which Property is Located	2009 Interest Rates
AgFirst, FCB	7.63%
AgriBank, FCB	6.50%
CoBank, ACB	6.17%
Texas, FCB	6.59%
U.S. AgBank, FCB	6.23%

Farm Credit System Bank	Location of Property
AgFirst, FCB	Delaware, District of Columbia, Florida, Georgia, Maryland, North Carolina, Pennsylvania, South Carolina, Virginia, West Virginia
AgriBank, FCB	Arkansas, Illinois, Indiana, Iowa, Kentucky, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, Tennessee, Wisconsin, Wyoming
CoBank, ACB	Alaska, Connecticut, Idaho, Maine, Massachusetts, Montana, New Hampshire, New Jersey, New York, Oregon, Rhode Island, Vermont, Washington
Texas, FCB	Alabama, Louisiana, Mississippi, Texas
U.S. AgBank, FCB	Arizona, California, Colorado, Hawaii, Kansas, New Mexico, Nevada, Oklahoma, Utah

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2. Rev. Rul. 2009-21, 2009-30 IRB 162.

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INTEREST RATES FOR NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS OF TAX 1999–2010

Calendar Quarter Beginning	Rate on Overpayments	Rate on Underpayments
1/1/2010	4%	4%
10/1/2009	4%	4%
7/1/2009	4%	4%
4/1/2009	4%	4%
1/1/2009	5%	5%
10/1/2008	6%	6%
7/1/2008	5%	5%
4/1/2008	6%	6%
1/1/2008	7%	7%
10/1/2007	8%	8%
7/1/2007	8%	8%
4/1/2007	8%	8%
1/1/2007	8%	8%
10/1/2006	8%	8%
7/1/2006	8%	8%
4/1/2006	7%	7%
1/1/2006	7%	7%
10/1/2005	7%	7%
7/1/2005	6%	6%
4/1/2005	6%	6%
1/1/2005	5%	5%
10/1/2004	5%	5%
7/1/2004	4%	4%
4/4/2004	5%	5%
1/1/2004	4%	4%
10/1/2003	4%	4%
7/1/2003	5%	5%
4/1/2003	5%	5%
1/1/2003	5%	5%
10/1/2002	6%	6%
7/1/2002	6%	6%
4/1/2002	6%	6%
1/1/2002	6%	6%
10/1/2001	7%	7%
7/1/2001	7%	7%
4/1/2001	8%	8%
1/1/2001	9%	9%
10/1/2000	9%	9%
7/1/2000	9%	9%
4/1/2000	9%	9%
1/1/2000	8%	8%
10/1/1999	8%	8%
7/1/1999	8%	8%
4/1/1999	8%	8%
1/1/1999	7%	7%

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INTEREST RATES ON CORPORATE OVERPAYMENTS AND UNDERPAYMENTS OF TAX 2006–2010

Calendar Quarter Beginning	Rate on Overpayments	Rate on Underpayments
Jan. 1, 2010	3%	4%
Oct. 1, 2009	3%	4%
Jul. 1, 2009	3%	4%
Apr. 1, 2009	3%	4%
Jan. 1, 2009	4%	5%
Oct. 1, 2008	5%	6%
Jul. 1, 2008	4%	5%
Apr. 1, 2008	5%	6%
Jan. 1, 2008	6%	7%
Oct. 1, 2007	7%	8%
Jul. 1, 2007	7%	8%
Apr. 1, 2007	7%	8%
Jan. 1, 2007	7%	8%
Oct. 1, 2006	7%	8%
Jul. 1, 2006	7%	8%
Apr. 1, 2006	6%	7%
Jan. 1, 2006	6%	7%

INTEREST RATES ON LARGE CORPORATE OVERPAYMENTS AND UNDERPAYMENTS OF TAX 2006–2010

Calendar Quarter Beginning	Rate on Overpayments	Rate on Underpayments
Jan. 1, 2010	1.5%	6%
Oct. 1, 2009	1.5%	6%
Jul. 1, 2009	1.5%	6%
Apr. 1, 2009	1.5%	6%
Jan. 1, 2009	2.5%	7%
Oct. 1, 2008	3.5%	8%
Jul. 1, 2008	2.5%	7%
Apr. 1, 2008	3.5%	8%
Jan. 1, 2008	4.5%	9%
Oct. 1, 2007	5.5%	10%
Jul. 1, 2007	5.5%	10%
Apr. 1, 2007	5.5%	10%
Jan. 1, 2007	5.5%	10%
Oct. 1, 2006	5.5%	10%
Jul. 1, 2006	5.5%	10%
Apr. 1, 2006	4.5%	9%
Jan. 1, 2006	4.5%	9%

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APPLICABLE FEDERAL RATES FOR OCTOBER 2007 THROUGH DECEMBER 2009

For the newest AFR tables, go to **www.irs.gov/taxpros/lists/0,,id=98042,00.html** .

October 2007

	Period For Compounding			
	Annual	**Semiannual**	**Quarterly**	**Monthly**
Short-term AFR	4.19%	4.15%	4.13%	4.11%
Mid-term AFR	4.35%	4.30%	4.28%	4.26%
Long-term AFR	4.88%	4.82%	4.79%	4.77%

November 2007

	Period For Compounding			
	Annual	**Semiannual**	**Quarterly**	**Monthly**
Short-term AFR	4.11%	4.07%	4.05%	4.04%
Mid-term AFR	4.39%	4.34%	4.32%	4.30%
Long-term AFR	4.89%	4.83%	4.80%	4.78%

December 2007

	Period For Compounding			
	Annual	**Semiannual**	**Quarterly**	**Monthly**
Short-term AFR	3.88%	3.84%	3.82%	3.81%
Mid-term AFR	4.13%	4.09%	4.07%	4.06%
Long-term AFR	4.72%	4.67%	4.64%	4.63%

January 2008

	Period For Compounding			
	Annual	**Semiannual**	**Quarterly**	**Monthly**
Short-term AFR	3.18%	3.16%	3.15%	3.14%
Mid-term AFR	3.58%	3.55%	3.53%	3.52%
Long-term AFR	4.46%	4.41%	4.39%	4.37%

February 2008

	Period For Compounding			
	Annual	**Semiannual**	**Quarterly**	**Monthly**
Short-term AFR	3.11%	3.09%	3.08%	3.07%
Mid-term AFR	3.51%	3.48%	3.46%	3.46%
Long-term AFR	4.46%	4.41%	4.39%	4.37%

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March 2008

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	2.25%	2.24%	2.23%	2.23%
Mid-term AFR	2.97%	2.95%	2.94%	2.93%
Long-term AFR	4.27%	4.23%	4.21%	4.19%

April 2008

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	1.85%	1.84%	1.84%	1.83%
Mid-term AFR	2.87%	2.85%	2.84%	2.83%
Long-term AFR	4.40%	4.35%	4.33%	4.31%

May 2008

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	1.64%	1.63%	1.63%	1.62%
Mid-term AFR	2.74%	2.72%	2.71%	2.70%
Long-term AFR	4.21%	4.17%	4.15%	4.13%

June 2008

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	2.08%	2.07%	2.06%	2.06%
Mid-term AFR	3.20%	3.17%	3.16%	3.15%
Long-term AFR	4.46%	4.41%	4.39%	4.37%

July 2008

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	2.42%	2.41%	2.40%	2.40%
Mid-term AFR	3.45%	3.42%	3.41%	3.40%
Long-term AFR	4.60%	4.55%	4.52%	4.51%

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August 2008

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	2.54%	2.52%	2.51%	2.51%
Mid-term AFR	3.55%	3.52%	3.50%	3.49%
Long-term AFR	4.58%	4.53%	4.50%	4.49%

September 2008

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	2.38%	2.37%	2.36%	2.36%
Mid-term AFR	3.46%	3.43%	3.42%	3.41%
Long-term AFR	4.58%	4.53%	4.50%	4.49%

October 2008

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	2.19%	2.18%	2.17%	2.17%
Mid-term AFR	3.16%	3.14%	3.13%	3.12%
Long-term AFR	4.32%	4.27%	4.25%	4.23%

November 2008

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	1.63%	1.62%	1.62%	1.61%
Mid-term AFR	2.97%	2.95%	2.94%	2.93%
Long-term AFR	4.24%	4.20%	4.18%	4.16%

December 2008

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	1.36%	1.36%	1.36%	1.36%
Mid-term AFR	2.85%	2.83%	2.82%	2.81%
Long-term AFR	4.45%	4.40%	4.38%	4.36%

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January 2009

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	0.81%	0.81%	0.81%	0.81%
Mid-term AFR	2.06%	2.05%	2.04%	2.04%
Long-term AFR	3.57%	3.54%	3.52%	3.51%

February 2009

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	0.60%	0.60%	0.60%	0.60%
Mid-term AFR	1.65%	1.64%	1.64%	1.63%
Long-term AFR	2.96%	2.94%	2.93%	2.92%

March 2009

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	0.72%	0.72%	0.72%	0.72%
Mid-term AFR	1.94%	1.93%	1.93%	1.92%
Long-term AFR	3.52%	3.49%	3.47%	3.46%

April 2009

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	0.83%	0.83%	0.83%	0.83%
Mid-term AFR	2.15%	2.14%	2.13%	2.13%
Long-term AFR	3.67%	3.64%	3.62%	3.61%

May 2009

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	0.76%	0.76%	0.76%	0.76%
Mid-term AFR	2.05%	2.04%	2.03%	2.03%
Long-term AFR	3.58%	3.55%	3.53%	3.52%

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June 2009

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	0.75%	0.75%	0.75%	0.75%
Mid-term AFR	2.25%	2.24%	2.23%	2.23%
Long-term AFR	3.88%	3.84%	3.82%	3.81%

July 2009

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	0.82%	0.82%	0.82%	0.82%
Mid-term AFR	2.76%	2.74%	2.73%	2.72%
Long-term AFR	4.36%	4.31%	4.29%	4.27%

August 2009

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	0.83%	0.83%	0.83%	0.83%
Mid-term AFR	2.80%	2.78%	2.77%	2.76%
Long-term AFR	4.26%	4.22%	4.20%	4.18%

September 2009

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	0.84%	0.84%	0.84%	0.84%
Mid-term AFR	2.87%	2.85%	2.84%	2.83%
Long-term AFR	4.38%	4.33%	4.31%	4.29%

October 2009

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	0.75%	0.75%	0.75%	0.75%
Mid-term AFR	2.66%	2.64%	2.63%	2.63%
Long-term AFR	4.10%	4.06%	4.04%	4.03%

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November 2009

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	0.71%	0.71%	0.71%	0.71%
Mid-term AFR	2.59%	2.57%	2.56%	2.56%
Long-term AFR	4.01%	3.97%	3.95%	3.94%

December 2009

	Period For Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term AFR	0.69%	0.69%	0.69%	0.69%
Mid-term AFR	2.64%	2.62%	2.61%	2.61%
Long-term AFR	4.17%	4.13%	4.11%	4.09%

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IRS AUDIT TECHNIQUE GUIDES

Aerospace Industry — Pub. Date: Jan. 2005

The IRS prepared a comprehensive audit technique guide (ATG) to assist examiners in evaluating research credit in the aerospace industry. The guide focuses on the particular unique aspects of the industry and provides examiners tools and tests to utilize in evaluating and auditing research credit.

Air Transportation — Pub. Date: Apr. 2008

Overview of excise tax paid for transportation of persons or property by air

Child Care Provider — Pub. Date: Mar. 2009

The child care provider ATG is intended to provide guidance to the examiner who is auditing a taxpayer in this industry and to provide tax-related guidance to taxpayers and other professionals in this industry.

Coal Excise Tax — Pub. Date: May 2005

Provides excise tax agents with specific tools to examine issues relating to domestically produced coal.

Commercial Banking — Pub. Date: May 2001

Overview of the industry; discusses potential issues and terminology unique to banking.

Construction Industry — Pub. Date: May 2009

Overview of the industry including a glossary; discusses types of contracts; types of contractors; methods of accounting; and joint ventures. This updated guide includes the filing locations for Rev. Proc. 92-29 elections (Chapter 7); includes contractor square footage costs (Chapter 11); and common errors in look-back interest filings (Chapter 5).

Cost Segregation — Pub. Date: Jan. 2005

The IRS prepared a comprehensive audit techniques guide to assist examiners in evaluating cost segregation studies submitted by taxpayers in support of depreciation deductions. The guide is also beneficial for taxpayers and practitioners in preparing these studies.

Credit for Increasing Research Activities (i.e. Research Tax Credit) IRC § 41 — Pub. Date: June 2005

This ATG sets forth the Research Credit Technical Advisors' suggested guidelines for auditing research credit issues.

Drywallers — Pub. Date: Aug. 1998

Overview of the industry; addresses specific aspects of a drywall contractor's business such as the business/economic environment, relationship with general contractor, and cash vs. accrual method of accounting.

Executive Compensation — Fringe Benefits — Pub. Date: Feb. 2005

Corporate executives often receive extraordinary fringe benefits that are not provided to other corporate employees. Any property or service that an executive receives in lieu of or in addition to regular taxable wages is a fringe benefit that may be subject to taxation.

Factoring of Receivables — Pub. Date: June 2006

This ATG focuses on a strategy in which multinational corporations use factoring of accounts receivable among related parties to avoid U.S. taxation by shifting income offshore and reducing U.S. income by deducting expenses related to the same income.

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Farmers — Pub. Date: July 2006

The agriculture industry ATG focuses on developing highly-trained examiners for the agricultural market segment. The guide contains examination techniques, common and unique industry issues, business practices, industry terminology and other information to assist examiners in performing examinations.

Farming — Specific Income Issues and Farm Cooperative — Pub. Date: July 1997

Overview of the industry; discusses potential for unreported income from primary farm income and nonfarming sources.

Foreign Insurance Excise Tax — Pub. Date: Apr. 2008

This ATG was designed to assist the examiner in conducting audits in which excise tax of foreign insurance transactions may be due.

General Livestock — Pub. Date: Apr. 2000

Provides a focus on the business of breeding, raising, buying and selling livestock.

Golden Parachutes — Pub. Date: Feb. 2005

The IRS has prepared a comprehensive ATG to assist examiners in evaluating parachute examinations. The parachute examination can occur during the examination of either the corporation's or the individual's return.

Grain Farmers — (PDF file under revision)

Overview of the industry; provides terminology and discusses topics such as underreporting of income, employment taxes, accounting methods, government farm programs, etc.

Hardwood Timber Industry — Pub. Date: Feb. 1998

Provides general and technical information useful to examiners in classifying, preplanning and examining returns relating to this industry.

Inland Waterways — Pub. Date: Dec. 2008

This ATG is intended to provide assistance to the examiner who is auditing a taxpayer for which the use of the inland waterways is an issue.

IRC 162(m) Salary Deduction Limitation — Pub. Date: Feb. 2005

Every publicly-held corporation maintains its executive compensation records differently. Likewise, every publicly-held corporation maintains different methods for compensating its executives. The examining agent must first learn the identity of the individual(s) within the corporation who are most familiar with how the executive compensation records are maintained.

IRC § 183: Activities Not Engaged in For Profit — Pub. Date: June 2009

This ATG was developed to provide guidance to revenue agents and tax compliance officers in pursuing the application of IRC §183, Activities Not Engaged in for Profit (sometimes referred to as the "hobby loss rule").

The Laundromat Industry — Pub. Date: June 2000

Provides an explanation of water consumption analysis for reconstructing unreported income from the operation of a laundromat. This method is to be used only when there is a reasonable indication of unreported income.

Lawsuit Awards and Settlements — Pub. Date: Jan. 2001

This ATG focuses on taxability of law suit awards and settlements.

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Ministers — Pub. Date: Apr. 2009

The Ministers ATG is intended to provide guidance to the examiner who is auditing a taxpayer who is a minister and to provide tax-related guidance to taxpayers and other professionals in this industry.

New Vehicle Dealership — Pub. Date: Jan. 2005

This ATG will give you the key to a quick and competent closure of any new vehicle dealership examination which hinges on narrowing the scope of the examination to items that may prove productive.

Non-Qualified Deferred Compensation — Pub. Date: Feb. 2005

The IRS has prepared a comprehensive ATG to assist examiners in evaluating nonqualified deferred compensation. A nonqualified deferred compensation (NQDC) plan is any elective or nonelective plan, agreement, method, or arrangement between an employer and an employee (or service recipient and service provider) to pay the employee compensation some time in the future.

Obligations Not in Registered Form — Pub. Date: June 2006

Oil and Gas Industry — Pub. Date: May 1996

Provides information on basic operations and common terminology. Includes reference to royalty owners and an introduction to financial products.

Ozone Depleting Chemicals (ODC) Excise Tax — Pub. Date: Sep. 2007

This ATG is used for industries involved with ozone depleting chemicals (ODC).

Partnerships — Pub. Date: Dec. 2002

The ATG focuses on issues that fall within IRC §§701 through 761 (Subchapter K). Subchapter K deals primarily with the formation, operation, and termination of partnerships. Many issues arise during the initial or final year of the partnership.

Passive Activity Losses — Pub. Date: Feb. 2005

Provides examiners with specific guidance on potential audit issues, issue identification and lead sheets and other job aids.

Placer Mining — Pub. Date: July 1999

Provides guidelines for the examination of taxpayers in this industry. Focuses on small mining operations represented as sole proprietorships on Schedule C, but can be adapted for partnership and corporate returns.

The Port Project — Pub. Date: Aug. 1995

Provides examiners assistance in auditing industries related to coastal and inland waterways.

Poultry Industry — Pub. Date: Dec. 2002

The purpose of this guide is to highlight issues that are specific to or have a large impact on the poultry industry. Most of the issues in this guide relate directly to the major companies rather than the individual farmers. However, one chapter was devoted to the issues normally found in conjunction with a poultry grower audit.

Reforestation Industry — Pub. Date: Aug. 1995

Overview of the industry; discusses issues that may be encountered, such as employment taxes; poor accounting records; etc.

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Rehabilitation Tax Credit — Pub. Date: Dec. 2002

Provides examiners with audit aids (i.e. issue checksheet, pro forma Information Document Request, and standardized audit reports, etc.) which assist in identifying and addressing common rehab tax credit issues.

Research Credit Claims: Credit for Increasing Research Activities § 41 — Pub Date: May 2008

This guide provides guidance on the handling and evaluation of research credit claims.

Retail Industry — Pub. Date: Feb. 2009

Sections 48A and 48B - Advanced Coal and Gasification Project Credits — Pub. Date: May 2009

Section 46 provides that the amount of investment credit for purposes of §38 for any taxable year is the sum of the credits listed in §46. Section 1307(a) of the Energy Tax Incentives Act of 2005, Pub. L. 109-58, 119 Stat. 594 (August 8, 2005), amended §46 to add two new credits to that list:The qualifying advanced coal project credit, (section 48A) and the qualifying gasification project credit, (section 48B).

Split Dollar Life Insurance — Pub. Date: Mar. 2005

Split-dollar life insurance arrangements can be a key feature of executive compensation packages. Over the years, the IRS has provided limited guidance regarding the taxation of these arrangements. Beginning in 2001, transitional guidance on the valuation of split-dollar life insurance arrangements was provided in the form of notices and proposed regulations in anticipation of final regulations.

Sports Franchises — Pub. Date: Aug. 1999

Focuses on major league franchises. Potential issues may include revenue (sponsorship, broadcast, season tickets), strike fund payments, stadium issues, player contracts, purchase/sale of franchise, league expansion, etc.

Stock-Based Compensation — Pub. Date: Feb. 2005

The IRS has prepared a comprehensive ATG to assist examiners in evaluating stock-based compensation. Stock-based compensation generally consists of either the transferring of stock or the issuance of stock options to an employee or independent contractor.

Structured Settlement Factoring — Pub. Date: Nov. 2006

Swine Farm Industry — Pub. Date: Dec. 2002

Overview of the industry includes methods of accounting (accrual vs. cash), farm price inventory, unit livestock price, prepaid feed, income from discharge of indebtedness, selection fees, depreciation, grower issues, penalties, research credits, employment taxes, and excise taxes.

Tobacco Industry — Pub. Date: Mar. 1996

Focuses on techniques for examining tobacco farmers, dealers and warehouse operations.

Veterinary Medicine — Pub. Date: Apr. 2005

Overview of industry includes discussion of types of business entities (especially personal service corporation); cash vs. accrual method of accounting; and inventory vs. supplies.

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