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## INDIVIDUALS

### Deferral of Required Minimum Distributions for 2009

Last January, we discussed new legislation enacted in late 2008 that provides relief with respect to the annual Required Minimum Distribution (RMD) that individual taxpayers over age 70½ must withdraw from their IRAs and qualified retirement plans in 2009. We noted that, as a result of this law change, the RMD for 2009 is waived, and the next RMD that must be withdrawn will be for calendar year 2010. This relief applies to lifetime distributions to employees and IRA owners as well as to after-death minimum distributions to beneficiaries of a decedent's retirement plan.

Due to the late enactment, some plans experienced administrative difficulties in offering plan beneficiaries the option not to receive their 2009 RMD or the option to roll over any 2009 distributions into other qualified retirement plans. As a result, some taxpayers have received unnecessary distributions this year and will be taxed on those distributions in 2009 unless corrective action is made available to them. To provide relief to these taxpayers, the IRS recently issued Notice 2009-82. This guidance allows individuals who received a 2009 RMD this year the option of either keeping the distribution or rolling it over into a qualified plan by the later of November 30, 2009, or 60 days after the date the distribution was received. Note that taxpayers are permitted to rollover one distribution from an IRA per year. However, the IRS applies this one-rollover-per-year rule on an IRA-by-IRA basis.

As an example, a taxpayer who received a $10,000 RMD for 2009 on March 1, 2009, now has until November 30, 2009, to rollover this distribution to a qualified plan to avoid current taxation. In the absence of this special relief provision, the taxpayer would have had to rollover that distribution by the end of April 2009 using the 60 day rule, or face current taxation. Alternatively, if the taxpayer

receives the distribution on October 30, 2009, the taxpayer will have until December 29, 2009, to rollover the distribution (60 days after the October 30th distribution). If the taxpayer has other IRAs, (s)he may rollover one 2009 RMD from each of these IRAs as well by November 30, 2009, or the 60th day following the distribution, if later. These rules are complex. Please call us if you have any questions regarding the amount or the timing for the rollover. The IRS web site at http://www.irs.gov/ep also provides additional information on rollovers of 2009 RMDs.

## Tax Exempt Bonds as Tax Credit Bonds

Congress permits state and local governments to issue tax credit bonds as an alternative to traditional tax-exempt bonds. Some versions of tax credit bonds do not pay interest. Rather, a tax credit accrues quarterly on the bond and is includible in the taxpayer's gross income as if it were an interest payment on the bond. Then, the taxpayer holding the bond on the "credit allowance date" (*i.e.*, March 15, June 15, September 15, and December 15) is permitted to claim a non-refundable tax credit against the taxpayer's regular income tax and alternative minimum tax liability. The effect is to provide the return to the bondholder in the form of a federal tax credit rather than a cash interest payment.

Recent tax bills have created several new types of tax credit bonds and extended the effective date of others. These include bonds issued for forestry conservation, renewable energy, energy conservation, school construction, and recovery zone economic development purposes.

*Build America Bonds.* The new Build America Bond program is intended to assist state and local governments in financing capital projects by lower borrowing costs. In general, these are interest-paying bonds that a state or local government issues between February 17, 2009, and January 1, 2011, and elects to treat as a tax credit bond. Holders of Build America Bonds continue to receive interest payments and are also entitled to a tax credit of 35% of the interest payable on the bonds. However, the interest income, plus the credit amount, must be included in income. For these bonds, the tax credit offsets some or all of the tax arising from including the interest in taxable income.

For both types of bonds, credits may be distributed to owners of pass-through entities such as S corporations and partnerships. Taxpayers will receive Form 1099-INT from the bond issuer reporting tax credits. Taxpayers are to use Form 8912, Credit to Holders of Tax Credit Bonds, to claim the credit. Any unused credit is not refundable, but can be carried forward to succeeding tax years. If you would like additional information regarding tax credit bonds, please contact us.

## IRS Liberalizes Home Mortgage Deduction Limit

There is good news from the IRS if the mortgage on your residence exceeds $1 million. A new interpretation of the tax laws by the IRS could result in a greater mortgage interest deduction for you for this year and perhaps for prior years as well.

Current tax law allows taxpayers to deduct interest paid on qualified residence acquisition debt up to $1 million and home equity debt up to $100,000. Acquisition debt refers to debt incurred by taxpayers

to purchase, construct, or substantially improve their home if the debt is secured by that home. Home equity debt refers to debt secured by the taxpayer's residence that may be used for other purposes (*e.g.*, to pay for vacations, private school, a new car, etc.). In calculating eligible residential interest, a taxpayer can use both the principal residence and one other vacation home, but both residences are subject to a single $1million acquisition debt limit or $100,000 home equity debt limit.

In the past, there has been uncertainty as to whether the home mortgage acquisition debt limit could be extended to include the $100,000 home equity rule, so as to allow $1.1 million of purchase or construction debt. Prior U.S. Tax Court cases have held that the $1 million home mortgage debt limit cannot be stretched to include the $100,000 home equity deduction if a taxpayer has a single acquisition debt in excess of $1 million. But in a recent ruling, the IRS issued an opinion contrary to the Tax Court cases (CCA 200940030 on 10/2/09). The IRS now states that individual homeowners may deduct residential interest expense generated by up to $1.1 million of direct acquisition debt. In effect, the IRS has recharacterized any amount of debt over $1 million that does not qualify as acquisition debt as home equity debt, up to the additional $100,000 limit.

What this means is that you may have an additional mortgage interest deduction for 2009 if your acquisition debt exceeds $1 million. In addition, you may be able to amend your income tax returns for 2008 and other open years to claim this increased mortgage interest deduction. We can help you determine whether you qualify for this increased deduction.

**New IRS Communication Tools**

To increase taxpayer awareness and use of the recently enacted 2009 tax benefits available to American families, the IRS now provides explanations of these benefits through YouTube videos, radio public service announcements, and multi-lingual informational flyers. This is in addition to a significant amount of information available on the IRS website at www.irs.gov/recovery. Topics include the First-time Homebuyer Credit, education and energy tax credits, the deduction for sales or excise taxes paid on the purchase of a new vehicle, and the Making Work Pay Credit. These products are in addition to earlier IRS efforts on YouTube (www.youtube.com/irsvideos) and iTunes to increase public awareness about the tax credits.

**Savings Bond Opportunities**

Under current law, individual taxpayers may check a box on Form 8888, which is filed with their tax return, and request that some or all of their tax refund be directly deposited into their checking and/or saving account. Beginning in early 2010, taxpayers will be able to use this form to request that some or all of their 2009 tax refund be used to purchase up to $5,000 in Series I U.S. Savings Bonds. Taxpayers will not have to open an account with the Treasury Department, have a bank account, or take any other action other than filing the tax return and checking the appropriate box. The savings bonds will be mailed to the taxpayer within three weeks of processing the individual's return. Initially, in 2009, taxpayers can purchase the bonds in their own name (or joint names for married taxpayers who file jointly). Beginning in 2011, taxpayers will be able to designate co-owners of the

bonds such as their children or grandchildren. For refunds up to $250, the bonds will be issued in $50 denominations. Beyond that, bonds will be issued in increments of $50, $100, $200, $500, and $1,000. For example, for a $1,000 refund, a taxpayer will receive six $50 bonds, one $200 bond, and one $500 bond.

Series I U.S. Savings Bonds are issued at face value (*e.g.*, a $50 bond costs $50) and generally can be redeemed for principal and accrued interest at any time after 12 months. The bonds accrue interest on the first day of each month, which is then compounded semi-annually. They continue to earn interest until redeemed at a financial institution or when they reach maturity in 30 years, if earlier. Savings bond interest income is exempt from state and local income tax. The federal income tax is deferred until redemption. However, taxpayers may elect to claim the interest annually. Some taxpayers may be able to exclude all or part of the interest earned from eligible savings bonds if it is used to pay for qualified higher education expenses. The bonds are subject to any applicable federal and state estate, inheritance, gift, and excise taxes. For more information on this new savings initiative, go to:

(http://www.irs.gov/retirement/article/0,,id=212061,00.html?portlet=6).

**BUSINESSES**

**Retirement Savings Initiatives**

With an eye towards helping Americans increase their savings, the IRS recently published guidance that would simplify procedures for employers who are willing to add enhancements to their qualified retirement plans. The first is a series of sample plan amendments to allow for automatic enrollment in 401(k) plans and SIMPLE IRA plans. The IRS has also provided sample language for plans with automatic contribution arrangements to increase the default percentage after the first year of participation.

In a second series of pronouncements, the IRS has issued a ruling permitting companies that pay out unused vacation or sick pay to allow employees to direct those amounts into their 401(k) plan. Similarly, retirement plans may be amended to permit unused vacation or sick pay that would be issued as compensation when an employee terminates, to instead be deferred into a qualified plan. Based on who exercises discretion over the transfer to the retirement plan, the funding is categorized as either employer contributions or employee elective 401(k) contributions.

Finally, the IRS has issued safe harbor language that may be used by an employer's qualified plan administrator to present an employee's options when receiving an eligible rollover distribution. This new guidance provides employers with a "rollover roadmap" that satisfies the required notice that employers must provide to employees who receive a distribution of their retirement plan account.
For more information about all of these new initiatives, see (http://www.irs.gov/retirement/article/0,,id=212061,00.html?portlet=6). We can also help to provide answers to your retirement plan questions.

**Record Retention Policies for Businesses**

You may not be aware that the IRS, in addition to providing rules for calculating tax liability and filing tax returns, also requires that taxpayers maintain for a period of time their books and records and other documents that support their tax return information. These rules ensure that your records will be available to the IRS in the event of a future tax audit. Generally, the record retention time period is based on the three-year statute of limitations period in which the IRS may assess a deficiency or the taxpayer may file an amended return. This period runs from the due date of your income tax return or the date you file that return, if later. For example, if you are a calendar year corporation and the 2009 income tax return for your business is due March 15, 2010, the three-year period will expire on March 15, 2013. However, if you filed your return for that year on the extended due date (September 15, 2010) or late (*e.g.*, November 1, 2010), the three-year period will lapse three years from the date you actually filed your return (September 15, 2013, or November 1, 2013, as the case may be).

In some circumstances, the three-year period may be extended or eliminated altogether. For example, a six-year statute of limitations will apply to taxpayers that have substantially understated their income (*i.e.*, omitted more than 25% of the gross income required to be reported in the return). A seven-year period applies to taxpayers who claim a bad debt or worthless stock deduction. There is no limitations period if the IRS determines that the tax return is fraudulent or was never filed. In that case, the IRS may assess tax at any time (*e.g.*, 10 years after the return should have been filed).

To comply with this record retention policy, taxpayers are generally advised to add an additional year to the three-year limitations period and retain their records for a four-year period. As an extra precaution, taxpayers may wish to retain their records for seven years, as has been informally suggested by the IRS. Keep in mind, however, that each state may have its own set of rules for retaining records, and some businesses will have compliance obligations in multiple states. Having business activity within a state (such as employees or property), and not reporting income tax or other taxes to that state, generally allows the state an unlimited examination and assessment period.

There are some records that taxpayers should keep for a longer period of time or indefinitely, such as records that establish the cost basis of property. These should be retained until the property is sold or otherwise disposed of. Certain documents, such as income tax returns, general ledgers, financial statements, results of an IRS or state tax audit, and legal documents such as insurance policies, real estate closing statements, and deeds should be retained forever.

The IRS has also published guidance for maintaining computer records (Rev. Proc. 98-25) and for maintaining records on an electronic storage system (Rev. Proc. 97-22). The computer records maintenance rules dictate how taxpayers with at least $10 million of assets at year-end must retain their accounting and financial data on a computerized system for future IRS examination or audit, if not maintained manually. These rules may apply to smaller taxpayers who use computers to support their tax return items or to calculate their tax liability. Taxpayers who fail to comply with the

computer record retention rules may be subject to significant penalties, including an accuracy-related penalty as well as a criminal penalty for intentionally disregarding these rules.

IRS rules permit the records to be stored electronically rather than in paper format. A taxpayer may generally destroy its original hard copies and maintain computerized records, but state requirements may differ from the IRS rules.

As a final matter, businesses should establish document destruction policies to avoid the loss of important data and to avoid penalties imposed by the IRS and the courts. Taxpayers should be able to show that their records were destroyed in the ordinary course of their business and that their policy complies with federal and state record retention policies. Taxpayers may be subject to penalties if their records are destroyed and are not available for audit or litigation purposes, or if they deliberately destroyed their records to eliminate any potential incriminating information. Please let us know if we can help you review your record retention policy.

**Opportunity to Forego Bonus Depreciation to Gain Refundable Credits**

The bonus depreciation rule that is in effect through December 31, 2009, permits businesses to claim an additional first year deduction equal to 50% of the adjusted basis of new property placed in service during the year. This generally results in favorable tax consequences for most taxpayers. Congress, however, recognized that there may be taxpayers incurring losses who would not benefit from accelerating their depreciation.

The tax law permits corporations to make an election to forego taking bonus depreciation in order to claim, as refundable tax credits, a portion of their deferred pre-2006 tax credits (*i.e.*, unused research tax credits and Alternative Minimum Tax credits). These refundable credits are limited under several computations. One of these limits requires a threshold amount of new equipment purchases during the year, based on the amount of carryover credits, in order to gain the maximum refundable credit for 2009. For example, a corporation with $50,000 of unused credits would need to acquire about $38,000 of new equipment during 2009 to maximize its refundable credit.

Recent IRS guidance advises how and when to make this election. This guidance is very detailed and complex. We can provide assistance in determining whether this new law is applicable to your business and whether you would benefit from electing not to claim bonus depreciation this year.

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