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Newsletter

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April 15 is a major tax day

As you know, Wednesday, April 15, is a big day in the world of taxes. It is the deadline for filing certain returns and taking certain tax-related actions. Here are the main forms due on April 15:

* Filing 2008 income tax returns for individuals. If you cannot complete your return by this deadline, be sure to file an extension request by April 15. The automatic extension (you don't need to explain to the IRS why you need more time) gives you until October 15, 2009, to file your return. **An extension does not,** however, give you more time to pay taxes you still owe. To avoid penalty and interest charges, taxes must be paid by April 15.

* Filing 2008 income tax returns for calendar-year Partnerships.
* Filing 2008 income tax returns for calendar-year Trusts and Estates.
* Filing 2008 annual Gift Tax returns.
* Making 2008 IRA contributions.
* Making the first quarterlies individual estimated tax payment for 2009.
* Amending 2005 Individual tax returns (unless the 2005 return had a filing extension).
  - Original filing of 2005 Individual income tax return to claim a refund of taxes.
  - NOTE: Each year many taxpayers have tax refunds due them for prior years, and unless a return is filed to claim the refund by the three-year statute of limitations, the refund is lost forever.

We wanted to cover some frequently asked questions about tax provisions in the Economic Stimulus Bill that President Obama signed - The American Recovery and Reinvestment Tax Act of 2009.

Individual Provisions

How quickly will people see a change in their paychecks as a result of the "Making Work Pay' provisions?

The IRS released new withholding tables reflecting the Making Work Pay credit on February 21 and said most taxpayers will see the credit in their paychecks this spring. The IRS asked employers to begin using the new withholding tables no later than April 1. The $400 credit will show up as about an extra $10 a week in the paychecks of eligible individuals. The Joint Committee on Taxation estimates the provision will cost $116.2 billion over 10 years.

Who is Eligible for the First-Time Home Buyer Credit?

The law provides an $8,000 tax credit for first-time homebuyers who buy a principal residence before December 1, 2009. The credit is available to home buyers who haven't owned their own primary residence for the past three years with incomes up to $75,000 for individuals and $150,000 for married couples. Unlike the $7,500 credit enacted last year, it doesn't have to be repaid unless you sell your home within three years. *Estimated cost is $6.64 billion over 10 years.*

Who Qualifies for the Auto Sales Tax Credit?

Buyers of new cars or light trucks can deduct the portion of state and local sales and excise taxes attributable to the first $49,500 of the vehicle's purchase price. The deduction is "above the line," which means taxpayers don't have to itemize deductions to claim it, and can be taken against the alternative minimum tax. The deduction is available to taxpayers with adjusted gross income of up to $125,000 for individuals and $250,000 for married couples. The deduction is good for purchases made from February 17, 2009 through December 31, 2009. The deduction can amount to $1,000 to $2,000 depending on the price of the car and the applicable tax rate in your state. *Estimated cost is $1.68 billion over 10 years.*

Are Unemployment Benefits Still Taxed?

With more people out of work, Congress exempted the first $2,400 in unemployment benefits from taxes in 2009. The law also provides a 65 percent subsidy for health insurance premiums maintained by laid-off workers under Cobra for up to 9 months. *Estimated cost is $4.74 billion over 10 years for unemployment provision and $24.7 billion for Cobra.*

What are the New Business Provisions?

Five Year Carryback of Net Operating Losses for Small Businesses with Less than $15 million in Revenues. This is an important provision for small businesses, which are often cash flow intensive, and there was a lot of advance publicity about congressional debate over this feature. Congress ended up allowing a small business with gross receipts of $15 million or less to carry back a 2008 Net Operating Loss (NOL) for as many as five years. (Without this provision current law allows an NOL to be carried back two taxable years and carried forward for twenty years). NOL carryback elections made in previous years can be changed, but only once and must be made on a timely basis. *Estimated cost is $947 million over 10 years.*

S corporations – Need to focus on three issues:

The S corporation is a popular form of business ownership. One reason for this is that S corporations avoid the double taxation that applies to regular C corporations, while still offering protection from personal liability.

However, as the popularity of S corporations continues to rise, they are facing greater scrutiny from the IRS. In particular, the IRS has focused its attention on three issues:

* Shareholder-owner compensation. The basic tax rule is that compensation paid to shareholder-employees must be reasonable in amount. Historically, the IRS has questioned compensation amounts paid to C corporation owners that seemed unreasonably high. With an S corporation, a high-tax bracket owner may establish a compensation amount that is extremely low – or even zero – while increasing other pass-through income (i.e., dividends). By doing so, the owner avoids employment taxes on these payments.

The IRS recognizes the tax benefits of this strategy. Therefore, they may object to compensation that appears to be low relative to corporate profits.

* Shareholder basis. Generally, a shareholder's "tax basis" for deducting corporate losses may be increased by contributing additional capital to the company, buying more stock, or lending funds to the company. The IRS may challenge basis adjustments resulting from loans by third parties to the company. Furthermore, it has consistently maintained that a shareholder's guarantee of an S corporation debt does not increase basis.

* Fringe benefits. An S corporation may provide tax-free fringe benefits, like health insurance or employer-paid group-term life insurance coverage (up to $50,000) to its employees. However, if an employee owning 2% or more of the company receives fringe benefits, he or she is generally taxed on the value. To avoid abuses, the IRS may examine fringe benefit packages. Note that there are several exceptions to the general rule. For example, certain "working condition" fringe benefits are tax-free to 2%-or-more shareholders.

S corporation owners must be careful to observe all the technicalities in the tax law to avoid problems with the IRS. If you have questions or need assistance, contact our office.