

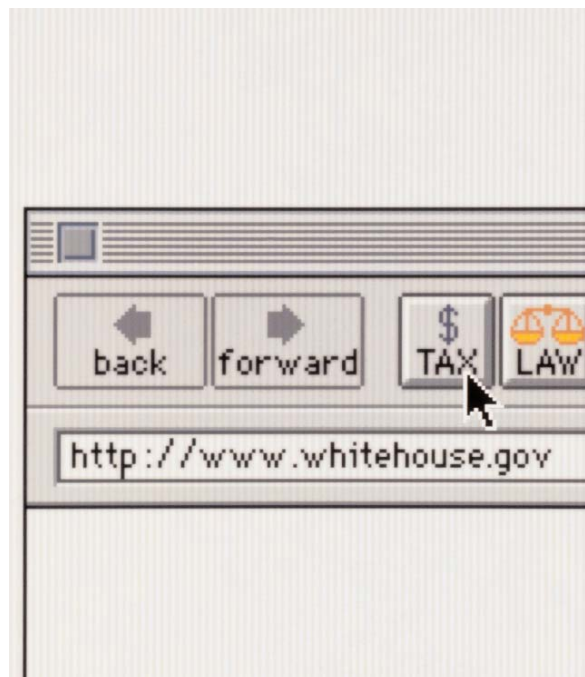
# the Competitive Edge

## Looking Back at 2009 and Getting Ready for Tax Time in 2010

Before 2010 begins in earnest, you may find it helpful to take one last look at important tax developments that occurred during 2009 to see what impact they may have on next year's tax strategies. To help, we have prepared a list of 2009 tax developments, selected from the perspective of their importance to you in 2010. Some of the developments on the list are ongoing, with endings yet to be written. With other developments, the law is firmly established, although application of some of them to New Year transactions may remain somewhat uncertain. In all cases, they are notable for their potential to play an important role in 2010 and beyond.

### Offshore Compliance

In 2010, the government will continue its follow-up work in pursuing disclosures made by UBS AG, as well as by individuals who, in 2009, disclosed names of advisors and other facilitators in record numbers. According to IRS Commissioner Doug Shulman, an "unprecedented" number of offshore account disclosures have been made. In addition, the IRS will make inroads in its multi-plank offshore tax reform plan, publishing (and enforcing) loophole-closing guidance such as recent temporary regulations that tightened restrictions on corporate inversion transactions.



### Net Operating Losses

Net operating losses took center stage in 2009 as the economic downturn continued to generate NOLs that were useless to many businesses as immediate cash generators under the regular two-year carryback provisions. The five-year 2008 NOL carryback for small businesses of the American Recovery and Reinvestment Act of 2009 and the modified five-year 2008 or 2009 NOL carryback option under the Worker,

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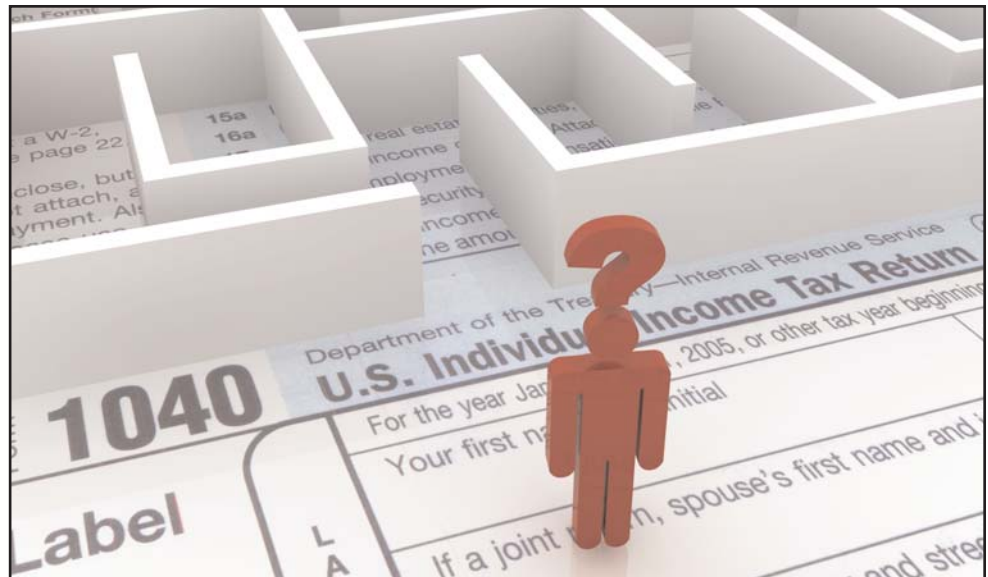
Homeownership, and Business Assistance Act of 2009 created much IRS guidance on elections and refund claims. Since the modified five-year election between 2008 and 2009 need not be made until the extended due dates for 2009 tax returns (although the business pressure to claim cash refunds immediately remains intense), NOLs – how to compute them, how to generate them, and how to claim them – are guaranteed to continue to be a hot focal point in 2010, as will the intense business pressure to claim cash refunds on the election as soon as possible.

### **Tax Gap**

As part of its effort to close the “tax gap” – the difference between what taxpayers owe and what is collected – the IRS (with encouragement from Capitol Hill) set into motion in 2009 an array of programs and initiatives that will expand in 2010. In addition to the offshore compliance initiative, IRS efforts will include a new employment tax audit program, plans to more tightly regulate tax return preparers, development of rules for credit card reporting on merchants, and laying the groundwork for implementing basis reporting by stockbrokers, as well as continuing the use of penalty provisions to create a virtual second tier of tax liability for missteps in determining when a tax strategy “crosses the line.”

### **Cancellation of Indebtedness Income**

Although the recession has put a damper on acquiring real income, there continues to be no lack of cancellation of indebtedness (COD) income – nor issues over how exceptions to COD income should operate. Guidance regarding certain COD income continues to be a work in progress and the Treasury Department has promised rules on certain COD income in early 2010.



### **Homebuyer Tax Credit**

The first-time homebuyer tax credit’s latest iteration extends through April 30, 2010 (or closings before July 1 on contracts executed before May 1). The credit has certainly been one of the most publicized tax breaks in recent years. As a result, many homeowners and real estate agents have acted first and then called on their tax professional to “confirm and collect” on the credit. Nevertheless, after-the-fact strategies are available for both 2009 and 2010 purchases. This is especially true in connection with the long-time homebuyer portion of the credit under which income, residency, and the election to claim on the prior year’s return offer some flexibility.

### **Change of Accounting**

In 2009, the IRS made significant revisions to its required procedures for taxpayers to obtain automatic IRS consent to a change in accounting method. A new revenue procedure added a number of methods for which taxpayers may obtain automatic consent and modified the rules that must be followed for obtaining automatic consent to an accounting method change. More companies are looking at accounting methods as part of their tax planning to enhance cash flow. Based on that evidence, filings

of accounting method changes should continue into 2010 at a record pace.

### **AFRs and Asset Value Historical Lows**

These days, it is difficult to have a below-market loan on which interest must be imputed considering that the rate charged would need to be below the current applicable federal rate (AFR). Low asset valuation also creates a particularly advantageous environment in which to convert from a corporation to a partnership, with taxable gain fixed in many cases at its lowest point in years. In addition to these factors, add the deadline created by the probability of higher taxes starting in 2011. 2010 strategies to take advantage of low interest rates and low values cannot be overemphasized.

### **Legislation**

The tax implications of health care reform, corporate tax reform, international tax reform, and a rise in the higher individual income tax rates will all impact on long-term tax strategies undertaken in 2010 – so will those issues continuing to arise from the bumper crop of 2008 and 2009 tax legislation we have just gone through. Without any new case law, Treasury regulations, or IRS initiatives in 2010, tax legislation will keep individuals and businesses busy.

# How to Convert Your Traditional IRA to a Roth IRA

Beginning in 2010, the income limitations that have prevented taxpayers with modified adjusted gross incomes of \$100,000 or more and married taxpayers that filed their returns separately from converting a traditional individual retirement account (IRA) to a Roth IRA are eliminated entirely. As a bonus to kick off “unlimited Roth conversions,” any income tax payments due on 2010 conversions may be deferred into 2011 and 2012. For higher-income individuals, 2010 presents a long-awaited opportunity to convert their savings into a Roth IRA providing tax-free distributions during their retirement years.

Eligibility for a Roth conversion in 2010 does not automatically make it a good decision for every taxpayer. Indeed, under the right circumstances, converting to a Roth IRA can provide potential significant tax and financial benefits. But every individual’s needs and circumstances are unique, and a Roth IRA conversion must be assessed in light of your particular tax and financial situation. In addition, converting to a Roth IRA is not a “do-it-yourself” transaction, and you should consult with a tax professional about the benefits and drawbacks relating to your personal situation.

The new conversion opportunity does not apply to funds held in a 401(k). The conversion opportunity applies to traditional IRAs, in addition to SIMPLE IRAs and SEP plans.

## Conversion Methods

A conversion to a Roth IRA may generally be accomplished by one of three means:

- *Rollover.* An IRA rollover involves making an eligible distribution from your traditional IRA that is rolled over into a Roth IRA within

60 days after the distribution. If the rollover does not occur within 60 days, it will be treated as an early withdrawal subject to a 10 percent early withdrawal tax as well as federal (and possible state) income taxation.

- *Trustee-to-trustee transfer.* If your IRA trustee is the same trustee for your traditional IRA and Roth IRA, you may have that trustee make the account transfer on your behalf. Additionally, if the trustee is not the same, your traditional IRA trustee can also transfer the funds to your new Roth IRA trustee on your behalf, even if they are not the same trustee for the accounts.
- *Account redesignation.* Regardless of type of means you use to convert to a Roth IRA, amounts converted from a non-Roth IRA to a Roth IRA are treated as distributed from the non-Roth IRA and rolled over to the Roth IRA. As mentioned above, a rollover must generally be effectuated within 60 days.

## Income Tax Consequences

The government is encouraging Roth conversions not only to shore up retirement savings but also to gain short time revenues. It accomplishes the latter because a conversion from a traditional IRA is counted as a taxable distribution in which income taxes must be paid. Unlike such distributions outside of a Roth conversion, however, no early withdrawal penalty is imposed. Since you would be taxed on your traditional IRA distributions eventually anyway upon retirement, having the distribution taxed at the time of a Roth conversion can be

viewed as an acceleration of that tax. In return, however, the funds that become part of your Roth account, including future earnings of them, become tax free forever into the future.

For conversions taking place in 2010, you have the option to elect to recognize the taxable income generated on the conversion amount ratably in adjusted gross income (AGI) in 2011 and 2012, instead of recognizing it all in 2010. This election does not spread the tax that would otherwise be paid in 2010 to 2011 and 2012; rather, it spreads the income realized in 2010, half into 2011 and half into 2012. That income, half in 2011 and half in 2012, is taxed at 2011 and 2012 rates, respectively, along with any other income normally realized for those years. It is important to “do the math” on this election before making any decision.

## Conversion Transaction

The institution or brokerage at which you maintain your traditional IRA will generally have a Roth Conversion Form, or similar document, that you must fill out to complete the transaction. The form may ask you for the name and account number of the IRA that you want to convert, whether you want to convert the entire amount of the traditional IRA, or only a part of the account, and the amount of the IRA you want to convert to the Roth IRA (or number of shares). Typically, the form will also inform you of your federal and state income tax withholding obligations regarding the transaction. You will have the opportunity to elect withholding, or elect not to have anything withheld from the funds in order to meet your anticipated income tax obligations from the transaction.

# Safe Harbor Regs Issued for Deferral Deposit Deadline

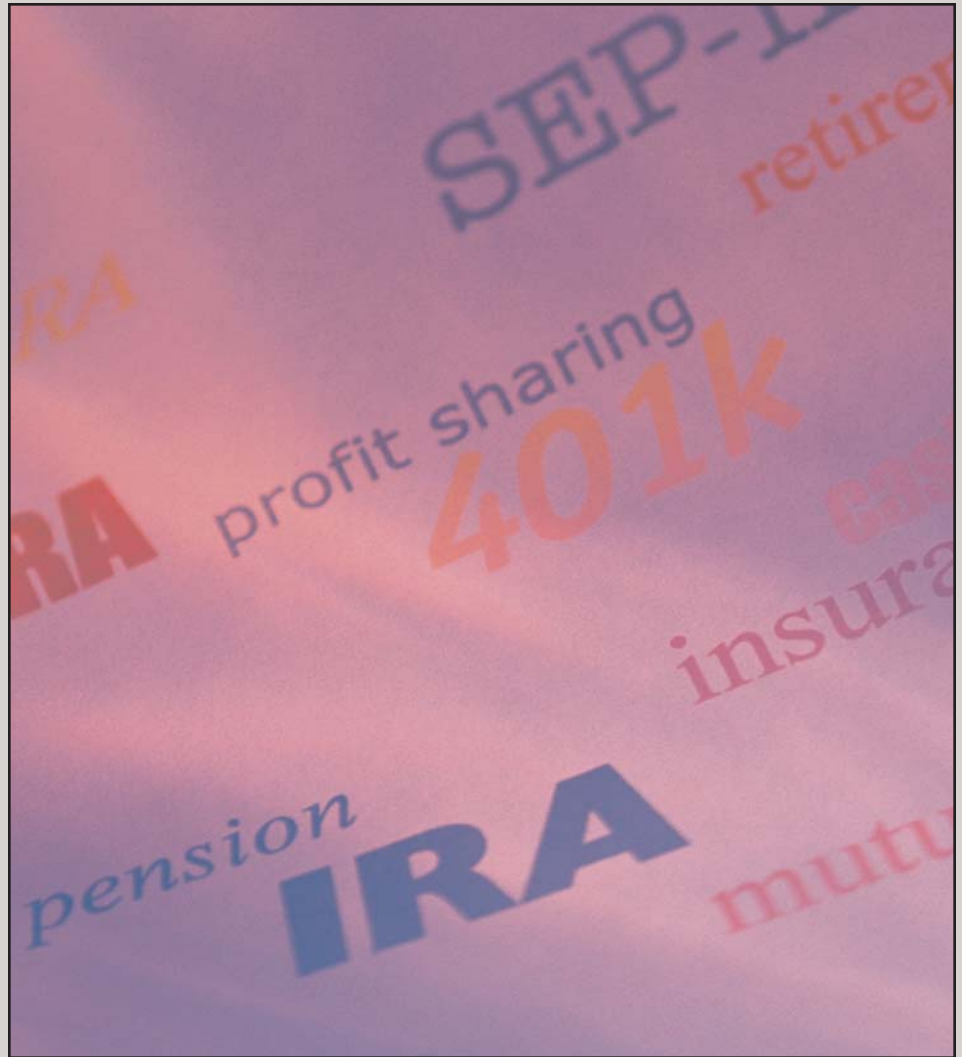
The U.S. Department of Labor has issued final regulations relating to deposits of participant salary deferrals and loan payments to a retirement or welfare benefit plan. The regulations create a safe harbor for plans with fewer than 100 participants, which, if satisfied, would allow the plans to automatically meet the law's requirements.

## The Safe Harbor Rule for Small Plans

As a general rule, deposits must be made by the earliest date on which such contributions or payments can reasonably be segregated from the employer's general assets. Under the final regulations, in the case of smaller plans, deposits will be treated as having been made to a plan in accordance with the general rule when:

- Amounts are deposited with the plan no later than the seventh business day following the day on which such amounts would otherwise have been payable to the participants in cash (in situations where money is withheld by an employer from a participant's wages), or
- Amounts are deposited with the plan no later than the seventh business day following the day on which such amounts are received by the employer (in the case of money that a participant or beneficiary pays directly to an employer, such as loan repayments)

Participant contributions will be considered deposited when placed in the plan's account, without regard to whether such contributions have been



allocated to specific participants or their investments.

The DOL clarified that following the safe harbor method is not the exclusive means through which employers may discharge their obligations to deposit participant contributions or loan payments and satisfy the general rule.

The final regulations state that the safe harbor method is available on a deposit-by-deposit basis. This means a failure to satisfy the safe harbor for any single deposit of participant contribution amounts to a plan will not result in the unavailability of the safe harbor for other deposits to the plan.

## Other Plans Covered

The final regulations cover other cash or deferred plans beyond traditional pension and welfare benefit plans. SIMPLE IRAs and SARSEPs are also included, although in the case of SIMPLE IRAs the date for depositing shall be no later than the 30th calendar day following the month the participant contribution amounts would otherwise have been payable to the participants in cash. The final regulations became effective January 14, 2010.

## IRS Further Clarifies COBRA Premium Subsidy Credit

The IRS has provided further guidance to one of its questions and answers (Q&As) relating to the COBRA premium subsidy credit available to employers. The latest guidance pertains to situations in which a credit is claimed for 2009 COBRA premium payments received in 2010.

A subsidy of 65% of the COBRA continuation health insurance premiums paid is available to individuals who have been involuntarily terminated. The American Recovery and Reinvestment Act of 2009 extended the premium subsidy provision from nine to 15 months. The employer providing the subsidy generally receives a credit for the subsidy amount on Form 941, *Employer's Federal Tax Return*.

The IRS previously provided guidance on commonly asked COBRA-subsidy-related issues in Q&A format on its website. One such question (FP-15) was: "Is the employer required to claim the credit on Form 941 for the quarter during which the COBRA subsidy is provided to an assistance-eligible individual?" The IRS answer is: "No. Instead of claiming the credit on Form 941 for the quarter during which the COBRA subsidy is provided, the employer may generally choose to claim the credit on Form 941 for a later quarter in the same calendar year."

The following inquiry was recently made to the IRS: If, in 2010, an employer receives payment of an assistance-eligible individual's 35% share of the COBRA premium for 2009 coverage, may the credit for the related employer-paid 65% premium subsidy be claimed for a quarter in 2009?

The IRS's response was "No." If an employer receives an assistance-



eligible individual's 35% share of the COBRA premium in 2010, the employer may claim the credit for the related premium subsidy on Form 941 for either the quarter in 2010 in which it receives the individual's 35% premium payment, or a later quarter in 2010, but not for a quarter in 2009, regardless of the fact that the premium is for coverage during 2009.

In all cases, however, if an employer chooses to reduce its payroll tax deposits during the quarter based on the employer's receipt of the individual's 35% premium payment during that

quarter, the employer must claim the credit for the related subsidy amount on Form 941 for the quarter during which its payroll tax deposits were reduced. Of course, an employer may only claim credit for the subsidy amount once.

The IRS's response should allay any concerns that existed among employers regarding the necessity to amend a 2009 employment tax return for affected COBRA premiums received after January 31, 2010, the deadline for filing 2009's Q4 Form 941.

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## The Competitive Edge – Winter 2010

# Haiti Relief Donations Qualify for Immediate Tax Relief

People who give to charities providing earthquake relief in Haiti can claim these donations on the tax return they are completing this season, according to the Internal Revenue Service.

Taxpayers who itemize deductions on their 2009 return qualify for this special tax relief provision, enacted January 22, 2010. Only cash contributions made to these charities after January 11, 2010, and before March 1, 2010, are eligible. This includes contributions made by text message, check, credit card, or debit card.

The new law only applies to cash (as opposed to property) contributions. The contributions must be made specifically for the relief of victims in

areas affected by the January 12 earthquake in Haiti. Taxpayers have the option of deducting these contributions on either their 2009 or 2010 returns, but not both.

To get a tax benefit, taxpayers must itemize their deductions on Schedule A. Those who claim the standard deduction, including all short-form filers, are not eligible.

Taxpayers should be sure their contributions go to qualified charities. Most organizations eligible to receive tax-deductible donations are listed in a searchable online database available on IRS.gov under Search for Charities. Some organizations, such as churches or governments, may be qualified even though they are not listed on IRS.gov. Donors can find

out more about organizations helping Haitian earthquake victims from agencies such as USAID.

Federal law requires that taxpayers keep a record of any deductible donations they make. For donations by text message, a telephone bill will meet the recordkeeping requirement if it shows the name of the donee organization, the date of the contribution, and the amount of the contribution.

### More to Come

Additional tax incentives to help Haiti may be in the pipeline. One proposal in Congress would extend an expired provision that allows an enhanced deduction for donations of food inventory. Doeren Mayhew will keep you apprised of any new details.