Halcolm Bard
Certified Public Accountant
& Consultants

TAX AND BUSINESS ADVISOR

Visit our web page at www.halcolm.com

TAX AND BUSINESS Alert™

May 2009

Tax Planning When Employment Is Terminated

Executives struggling through a job change caused by a corporate downsizing or restructuring frequently overlook the tax and financial consequences of events associated with the layoff or termination. Yet, proper handling of these aspects may ease the executive's transition through the career change.

The former employer may offer a variety of job and financial assistance programs intended to smooth the executive's transition to a new career. Companies terminating executives frequently offer severance payments intended to mitigate the sting of termination and job placement services to assist the executive in finding new employment. Companies hiring executives often provide financial assistance to cover moving expenses and relocation costs.

Severance or dismissal pay, including an amount paid in lieu of a termination notice, is taxable income to the executive regardless of whether the employer is legally bound to make the payment. However, the value of job placement assistance provided by an employer to a terminated or laid-off executive generally may be excluded from the executive's income as a working condition fringe benefit.

Photos.com

Qualified moving expense reimbursements are excluded from an executive's income. A qualified moving expense reimbursement includes any amount received, directly or indirectly, by an executive from an employer as a payment for, or a reimbursement of, expenses that would have been deductible as moving expenses on the executive's personal tax return if directly paid or incurred by the executive.

Generally, distributions from a qualified retirement plan (less any nondeductible employee contributions) are taxed as ordinary income. A 10% penalty tax applies to distributions before age 59½, unless they are part of a series of substantially equal payments, or they are received due to separation from service after age 55, death or disability, and certain other exceptions.

COBRA Premium Subsidy

The American Recovery and Reinvestment Act of 2009 (Stimulus Act) provides a unique benefit for recently released workers wanting to maintain their health insurance coverage. As background, group health plans maintained by employers that have at least 20 employees are required to offer certain employees and their dependents the opportunity to continue to participate in the group health plan for up to 18 months after leaving the company. This is referred to as COBRA continuation coverage.

The Stimulus Act provides for a 65% government subsidy for COBRA continuation payments for up to nine months to Assistance Eligible Individuals (AEIs) for periods of coverage beginning on or after February 17, 2009. The remaining 35% is paid by the AEI. An AEI is an employee (and COBRA-eligible family members) whose employment has been involuntarily terminated between September 1, 2008 and December 31, 2009, and who elects COBRA coverage. AEIs who were involuntarily terminated after August 31, 2008 and before February 17, 2009, and did not enroll for COBRA benefits at the time of their termination, had a special extended 60-day period in which to elect COBRA benefits.

Sales Tax Write-offs for Vehicles and Motor Homes

A provision in the recent Stimulus Act provides that qualified motor vehicle taxes are deductible as either an itemized deduction or as a component of the standard deduction. The Stimulus Act establishes a temporary itemized deduction equal to the amount of state and local sales and excise taxes paid on a qualified vehicle purchase between February 17, 2009 and December 31, 2009. However, the additional itemized deduction is limited to taxes allocable to the first $49,500 of the purchase price.

Photos.com

The new law also establishes a temporary add-on standard deduction with similar conditions and limitations for individual taxpayers who don't itemize. The add-on standard deduction, but not the itemized deduction, is allowed for both regular tax and AMT purposes.

The new itemized and add-on standard deduction write-offs are only available for state and local sales and excise taxes on new (not used) (1) passenger autos and light trucks with gross vehicle weight ratings of 8,500 pounds or less, (2) motorcycles, and (3) motor homes.

Note the additional itemized deduction is not allowed to an itemizing individual who elects to deduct state and local sales taxes in 2009 in lieu of deducting state and local income taxes. Electing taxpayers can effectively claim itemized deductions for state and local sales taxes on new (or used) vehicle or motor home purchases anyway—without regard to the $49,500 purchase price limitation. So the new itemized deduction privilege under the Stimulus Act is generally redundant for these individuals. However, the new add-on standard deduction provision is allowed for AMT, whereas the amount deducted in lieu of state and local income taxes is not.

The additional itemized deduction or new add-on standard deduction (whichever applies) is subject to phase-out provisions. The phase-out range for unmarried individuals and married individuals who file separately is between modified adjusted gross income (MAGI) of $125,000 and $135,000. The phase-out range for married joint-filing couples is between MAGI of $250,000 and $260,000. For this purpose, MAGI is regular adjusted gross income (AGI) increased generally by tax-exempt income from outside the U.S.

American Opportunity Credit

For tax years beginning in 2009 and 2010, the Stimulus Act includes taxpayer-friendly modifications to the Hope Scholarship higher education tax credit (Hope Credit). The Hope Credit is also temporarily renamed the American Opportunity Credit (Opportunity Credit). Under the revamped rules, the Opportunity Credit equals 100% of the first $2,000 of qualified post-secondary education expenses paid during the year plus 25% of the next $2,000. So the maximum annual credit is now $2,500. Under prior law, the maximum Hope Credit for 2009 was only $1,800, and it probably would be about the same for 2010.

The Opportunity Credit covers the cost of tuition, fees, and course materials (but not room and board) for the first four years of post-secondary education in a degree or certificate program. It is unavailable if the student has already completed four years worth of academic hours as of the beginning of that year. Under prior law, the Hope Credit was only allowed for the first two years of post-secondary study, and the cost of course materials did not count as a qualified expense.

The Opportunity Credit is only allowed for a year when the student carries at least half of a full-time load for at least one academic period beginning in that year (same as under the prior-law Hope Credit rules). Also, as under the prior law, married individuals who file separately are ineligible.

The Opportunity Credit is subject to phase-out rules, but they are considerably more lenient than the prior-law Hope Credit rules. The Opportunity Credit phase-out range for unmarried individuals is between modified adjusted gross income (MAGI) of $80,000 and $90,000. The phase-out range for married joint filers is between MAGI of $160,000 and $180,000. These ranges will also apply for 2010 without any inflation adjustments. Under the prior-law Hope Credit rules, the phase-out ranges for 2009 would have been $50,000–$60,000 and $100,000–$120,000, and the ranges for 2010 would probably remain the same. For this purpose, MAGI is defined as regular adjusted gross income (AGI) increased by income from outside the U.S. that was excluded from taxable income.

Photos.com

The Opportunity Credit is allowed to offset the taxpayer's entire federal income tax liability, including any AMT. In addition, up to 40% of the Opportunity Credit can be refundable, meaning you can receive a refund even if you did not have taxes withheld or make any estimated payments. However, the refundability privilege is not allowed to taxpayers who fall under the dreaded Kiddie Tax rules (which can potentially hit students who are up to 23 years old as of year-end). Finally, special refundability limitations apply to residents of U.S. possessions (including the Commonwealths of Puerto Rico and the Northern Mariana Islands).

The new law doesn't make any changes in the Lifetime Learning higher education tax credit (Lifetime Credit) rules. As you may know, the Lifetime Credit can be as much as $2,000 (based on 20% of up to $10,000 of qualified tuition and fees). As before, the Lifetime Credit can help offset graduate school tuition costs and tuition for non-degreed education such as professional education and certification courses.

Note that for 2009, the Lifetime Credit is phased out between MAGI of $50,000 and $60,000 for unmarried taxpayers and between MAGI of $100,000 and $120,000 for married joint-filing couples. Obviously, the phase-out ranges for the Opportunity Credit are considerably higher.

Capitalizing an LLC

In the midst of difficult and uncertain economic times, entrepreneurs continue to find opportunities for forming a new business or reformulating an existing business. If you or your investment group find yourself in this position, it's a good bet that you want to limit your exposure to lawsuits and liabilities in general. Creating a limited liability company (LLC) classified as a partnership is one way to achieve that goal.


Photos.com

The creation and operation of an LLC usually involves transfers of money and property from the members to the LLC. As a general rule, no gain or loss is recognized on a contribution of money or unencumbered property to an LLC. This is true whether the contribution occurs at the time of formation or at a later date. In the LLC setting, there is no requirement that the contributor(s) control the organization after the contribution. The recipient LLC recognizes no gain or loss on the receipt of contributed property from a member. This ability to contribute property to LLCs on a tax-free basis, coupled with the ability to, in many instances, distribute property from LLCs without recognition of gain or loss by the member or the LLC, is often a significant reason for conducting a business venture in the LLC form.

As always, there are exceptions to this general rule. A contribution can result in a taxable event (a) when the contribution is not classified as property (i.e., services), (b) when excess liabilities are assumed by the LLC or the other members, or (c) when the investment company or disguised sale rules apply. However, the flexibility of the LLC tax rules often allows for creative methods to either minimize the potential for immediate gain recognition or eliminate it without changing the transaction's overall economic impact.

This information provides a basic overview of contributions made upon the formation of an LLC. We realize that this information is somewhat technical. So, please contact us if you would like to discuss this topic in more detail.

Alert
May 2009