

MARCH 2009

# Client Bulletin

BUSINESS & TAX PLANNING IDEAS *for* OUR CLIENTS *and* FRIENDS

## A Holiday for Required Minimum Distributions

At year-end 2008, the Worker, Retiree, and Employer Recovery Act of 2008 became law. Among its many provisions, this new law suspends required minimum distributions (RMDs) from traditional IRAs, 401(k)s, and other retirement accounts for 2009.

### Relief from the 50% penalty

Individuals older than 70½ generally are required to take at least a certain amount from their retirement plans each year. An IRS table determines the RMD. Any shortfall is subject to a 50% penalty. In 2009, however, there will be no RMD and no 50% penalty.

**Example:** Beth Williams is a 76-year-old widow. She had \$400,000 in her IRA at year-end 2008. At her age, IRS tables require Beth to withdraw at least ½ of her IRA. Thus, Beth normally would have had to take \$18,182 from her IRA in 2009, even if she didn't need the money. If Beth had failed to make any withdrawal, she would have owed a \$9,091 (50%) penalty.

The new law was spurred by Congress's belief that seniors such as Beth might have to sell securities at low prices in order to meet the RMD rules. Therefore, pursuant to the new law, those rules are not in effect this year. Beth can leave her IRA untouched, if she wishes, and hope that the securities inside her account regain some of their lost value.

### Still a taxing issue

As you can see, this RMD relief affects seniors who need to take little or nothing

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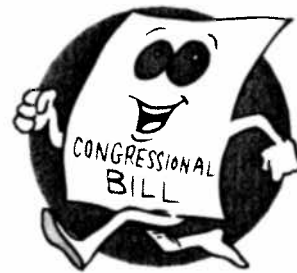
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#### Did You Know?

High-income seniors pay more than others for Medicare Part B, which covers doctors' bills and other outpatient charges. In 2008, most Medicare participants pay \$96.40 per month for Part B. Those with modified adjusted gross income (MAGI) over \$85,000 in 2007 (over \$170,000 on a joint return) pay more, depending on income. The highest premium is \$308.30 per month, paid by those with 2007 MAGI over \$213,000 (single) or \$426,000 (joint).

Source: Medicare.gov

from their IRAs. Retirees who need to tap their IRAs for living expenses can do so; they'll owe ordinary income tax on all withdrawals, as before. What's more, Congress has not relaxed the 10% penalty on withdrawals from IRAs and other retirement accounts before age 59½. If you need to tap your retirement funds before that age, ask our office for details on how you may be able to avoid owing the 10% surtax.



### Nonspouse beneficiaries get a benefit

A less publicized but perhaps even more important provision of the new law affects nonspouse beneficiaries of employer-sponsored retirement plans. Many of these plans have forced such beneficiaries to withdraw the inherited funds within a relatively short time period, thus limiting ongoing tax deferral.

The Pension Protection Act of 2006 allowed such nonspouse beneficiaries to roll over an account from an employer-sponsored plan to an IRA. Subsequently, these beneficiaries can stretch distributions over their life expectancy for more tax deferral. After the Pension Protection Act was passed, though, the IRS released Notice 2007-7, which indicated that the nonspouse stretchout was discretionary. According to this notice, employers could choose whether to allow such a



America Counts on CPAs

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stretchout or to force nonspouse beneficiaries to withdraw the money more rapidly.

Some observers believed that the IRS notice was contrary to Congress's intent. In this new law, Congress has confirmed that all employers must offer a stretchout to nonspouse beneficiaries. However, employers don't have to include the stretchout option until 2010. In 2009, employers may insist upon a faster payout.

### **Roth IRA rescue**

Another provision of the new law affects participants in Roth 401(k) and

Roth 403(b) plans. Participants in these plans contribute after-tax dollars. After five years and age 59½, all distributions from a Roth 401(k) or a Roth 403(b) are tax-free. Often, taxpayers who expect to be in a higher tax bracket in retirement (such as young workers with relatively low salaries) are better off in a Roth 401(k) or a Roth 403(b) than in a traditional 401(k) or 403(b) plan.

When you leave an employer, you are eligible to roll your Roth account to a Roth IRA or to another employer's Roth retirement plan. Many participants prefer the Roth IRA because

they have more control over their investments. Roth IRAs have the same requirements (five years, age 59½) for tax-free withdrawals.

Because of a glitch in the tax law, though, taxpayers with modified adjusted gross income (MAGI) over \$100,000 could not roll over a Roth 401(k) or a Roth 403(b) to a Roth IRA in 2009. The new law says that such rollovers are permitted for all taxpayers, including those with MAGI over \$100,000, in 2009. In addition, the new law confirms that such rollovers won't trigger taxable income.

## **Climbing the Yield Curve**

Back in mid-2007, the *yield curve* was flat. That is, if you plotted bond yields and bond maturity dates, you'd see that yields were about the same for all maturities. A three-month Treasury bill (which is virtually the same as cash) paid around 4.5%. You would have earned little more by investing in 10-year Treasuries (which were yielding 4.8%) or 30-year Treasuries (5%). For such a slight increase in yield, you would have had to bear much more interest rate risk: If interest rates rise, bond prices fall, and long-term bonds lose more value than short-term bonds.

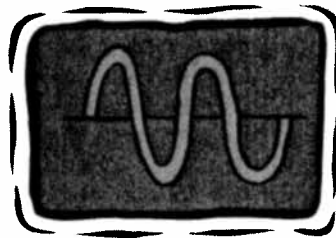
Therefore, in 2007 investors had little to gain and much to lose by choosing long-term over short-term bonds.

### **Steeper slope**

As of this writing, the yield curve has assumed a more normal shape. That is, investors are rewarded (with higher yields) for assuming more risk (longer bond maturities). In Treasuries, three-month bills now yield virtually nothing. If you are willing to take some interest rate risk, however, you can get

about 2.5% from a 10-year Treasury and 3% from a 30-year Treasury.

Surprisingly, municipal bonds have higher yields than Treasuries now. This is unusual because investors owe federal income tax on the interest from Treasuries, while they owe no federal income tax on municipal bond interest. Therefore, muni yields usually are lower than Treasury yields.



That's not the case now. Investors have poured money into Treasury bonds—backed by the federal government—driving up prices and pushing down yields. Simultaneously, investors have backed off from munis because they fear that economic woes will hamper state and local governments' ability to pay bond interest.

AAA-rated, 10-year municipal bonds now pay nearly 4%, while 30-year munis yield more than 5%. After tax, investors will wind up with much higher returns from top-rated munis than they would from Treasuries.

### **The annuity alternative**

A steep yield curve also makes deferred fixed annuities more attractive than they were when the curve was flat. The Beacon Research Fixed Annuity Premium Study found that total sales in the first three quarters of 2008 topped \$70 billion, which was 50% higher than sales in the first three quarters of 2007.

With a deferred fixed annuity, you invest your money and receive a specific return for a specified time period. At the end of that term, the company issuing the annuity will reset the contract for another period of time at prevailing interest rates. You won't owe income tax until you withdraw funds.

Today, fixed annuities generally are paying 5%–6% per year to investors who choose a term of 5–7 years. This type of tax-deferred yield may be very appealing.

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## Take an Active Role in Using Passive Losses

Many real estate investors have suffered setbacks from recent turmoil in the economy and the financial markets. If you sold a property last year, you might overlook a key tax benefit when you prepare your 2008 tax return. Similarly, if you sell investment property this year you should remember to use any suspended *passive activity losses* on your 2009 tax return.

### Passive activity losses

Even in good times, real estate investors may show losses from their ventures, for tax purposes. Depreciation deductions help to generate such losses, even if you receive more cash from rental income than you actually spend on running the property. In bad times, your losses may increase as rental income declines.

Either way, such tax losses are passive activity losses—losses from a business in which you do not actively participate. Under the tax code, you usually must treat rental real estate as a passive activity, even if you're the one who screens tenants and fixes the plumbing. You generally can deduct such passive losses only against passive activity income.

**Example #1:** Shannon Davis owns two rental properties. In 2008, she had a \$20,000 loss from one property and \$30,000 of taxable income

from the other one. She can net these results and report \$10,000 of passive income on her tax return for the year.

### The \$100,000–\$150,000 question

Some real estate investors will have passive losses from one or more properties but no passive income. Can they deduct those losses? Yes, but they might have to wait for many years.

In most cases, taxpayers whose adjusted gross income (AGI) is under \$100,000 can deduct up to \$25,000



in passive losses. That \$100,000 limit applies to both single and joint tax returns. Between \$100,000 and \$150,000 in AGI, your permitted loss gradually declines to zero.

In order to deduct any passive losses, you must meet certain conditions. You must have at least a 10% interest in the property. Also, you must own your share directly, not

through an entity such as a limited liability company or a limited partnership. In addition, you must take part in some management decisions such as approving tenants and setting rent levels.

**Example #2:** Bryan Parker owns one rental property and makes management decisions. This property generated a \$20,000 loss in 2008. Bryan's AGI in 2008 was \$140,000. This AGI is 80% through the \$100,000–\$150,000 phaseout range, so he can deduct only 20% of the \$25,000 maximum: \$5,000. If Bryan can deduct \$5,000 of his \$20,000 loss, what happens to the other \$15,000? He can't deduct it right away, but he can carry it forward to future years as a suspended passive loss.

### Use it, don't lose it

If Bryan owns the property for many years, he may build up a large bank of suspended losses. When he disposes of his interest in the property, he can use all of his suspended losses. That's true no matter how large his AGI is that year.

Therefore, if you sold rental property last year, don't forget to include any accumulated suspended losses when you calculate your gain or loss from the venture. Our office can help you recognize any suspended losses on your 2008 tax return.

### continued from page 2 — Climbing the Yield Curve

However, investors should tread carefully with fixed annuities. If you invest, you should pick a financially strong issuer that is likely to be able to pay the promised amounts some years in the future. You also should know

what surrender charges will apply and how long such charges will be enforced. If you are interested, our office can help you evaluate the financial strength of fixed annuity issuers and understand their surrender charges.

**Resource:** To see graphs of current yield curves in the U.S. and other countries, go to [www.yieldcurve.com](http://www.yieldcurve.com) and click on Yield Curves on the left side of the home page.

# Tax Calendar

## MARCH 2009

### March 16

**Corporations.** File a 2008 calendar year income tax return (Form 1120 or 1120-A) and pay any tax due. If you want an automatic six-month extension of time to file the return, file Form 7004 and deposit what you estimate you owe.

**S corporations.** File a 2008 calendar year income tax return (Form 1120S) and pay any tax due. Provide each shareholder with a copy of Schedule K-1 (Form 1120S), *Shareholder's Share of Income, Deductions, Credits, etc.*, or a substitute Schedule K-1. If you want an automatic six-month extension of time to file the return, file Form 7004 and deposit what you estimate you owe.

**S corporation election.** File Form 2553, Election by a Small Business Corporation, to choose to be treated as an S corporation beginning with calendar year 2009. If Form 2553 is filed late, S treatment will begin with calendar year 2010.

**Electing large partnerships.** Provide each partner with a copy of Schedule K-1 (Form 1065-B), *Partner's Share of Income (Loss) From an Electing Large Partnership*, or a substitute Schedule K-1. This due date is effective for the first March 16 following the close of the partnership's tax year. The due date of March 16 applies even if the partnership requests an extension of time to file Form 1065-B by filing Form 7004.

**Employers.** For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in February if the monthly rule applies.

## APRIL 2009

### April 15

**Individuals.** File a 2008 income tax return. If you want an automatic six-month extension of time to file it, file Form 4868, *Application for Automatic Extension of Time To File U.S. Individual Income Tax Return*, or you can get an extension by phone or online. Then file Form 1040, 1040A, or 1040EZ by October 15.

If you are not paying your 2009 income tax through withholding (or will not pay in enough tax during the year that way), pay the first installment of your 2009 estimated tax. Use Form 1040-ES.

**Employers.** For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in March if the monthly rule applies.

**Household employers.** If you paid cash wages of \$1,600 or more in 2008 to a household employee, file Schedule H (Form 1040) with your income tax return and report any employment taxes. Report any federal unemployment (FUTA) tax on Schedule H if you paid total cash wages of \$1,000 or more in any calendar quarter of 2007 or 2008 to household employees. Also report any income tax you withheld for your household employees.

**Partnerships.** File a 2008 calendar year return (Form 1065). Provide each partner with a copy of Schedule K-1 (Form 1065), *Partner's Share of Income, Deductions, Credits, etc.*, or a substitute Schedule K-1. If you want an automatic six-month extension of time to file the return and provide Schedule K-1 or a substitute Schedule K-1, file Form 7004. Then file Form 1065 by October 15.

**Electing large partnerships.** File a 2008 calendar year return (Form 1065-B). If you want an automatic six-month extension of time to file the return, file Form 7004. Then file Form 1065-B by October 15.

**Corporations.** Deposit the first installment of estimated income tax for 2009. A worksheet, Form 1120-W, is available to help you estimate your tax for the year.

In accordance with IRS Circular 230, this newsletter is not to be considered a "covered opinion" or other written tax advice and should not be relied upon for IRS audit, tax dispute, or any other purpose.

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