

# Taxing Times

Tax information for clients and friends of Stambaugh Ness



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By Tax Advisor Colette Brownson  
Tax Specialist Melissa J-L Myers

**Topics Announced ...**  
For our no-charge, annual December Payroll Seminars

**"PAYROLL PLUS - How to Improve Your Payroll Processes"**

Registration will open next week. [Get more details here.](#)

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## INDIVIDUAL TAX NEWS TAX PLANNING SERIES

*Over the past few monthly editions, we have provided you with some tips for tax planning in 2009. This month, we will discuss planning for miscellaneous sources of income.*



[Tax Specialist  
Melissa J-L Myers](#)

### Self-Employment Tax for Businesses Abroad

The rules for paying self-employment tax are generally the same whether the individual is living in the United States or abroad. These individuals must take into account all of their self-employment income in computing net earnings from self-employment, including income that is exempt from income tax because of the foreign earned income exclusion. Although nonresident aliens are not subject to self-employment tax, self-employment income received while an individual is a resident alien is subject to self-employment tax, even if it was paid for services the individual performed as a nonresident alien.

To alleviate the possibility of double taxation of foreign source income, U.S. citizens and residents are permitted either to deduct or claim a credit for foreign income taxes paid on any foreign source income that is also subject to U.S. tax. Self-employed U.S. citizens or residents abroad are subject to the federal tax on self-employment income even though they satisfy either the bona fide residence test or the physical presence test. All earned income must be taken into account in computing the self-employment tax, even if the income is exempt from tax because of the foreign earned income or housing exclusion.

**MELISSA'S COMMENTS:** *"U.S. citizens residing abroad are taxed as though they resided in the United States unless an agreement between the United States and the country in which they reside exempts them from*

*self-employment taxes. If there is no agreement, any foreign income and housing cost exclusions allowed for income tax purposes must be disregarded in computing net earnings from self-employment."*

### **Hobby Income**

Generally, if an activity is not carried on for profit, allowable deductions cannot exceed the gross receipts for the activity. Income from all sources, including hobby income, must be reported to the IRS. If the activity is a trade or business, the taxpayer may deduct ordinary and necessary expenses. Although the cost of doing business generally is fully deductible, the cost of personal enrichment is not. The primary factor used by the IRS to differentiate between a hobby and a business is "profit motive". If the taxpayer is able to demonstrate that he/she undertook an activity with the objective of making a profit, the ordinary and necessary expenses that result generally are deductible, even if the net result is a loss.

The expenses of an activity the taxpayer undertakes for purposes of hobby, recreation, or enjoyment, however, are deductible only to the extent of any income that specific activity generates. This is then subject to the limitations on miscellaneous itemized deductions. Excess expenses cannot be used to offset income from other sources. Without the intent-to-profit there can be no tax loss. This is commonly referred to as the "hobby loss" rule.

**MELISSA'S COMMENTS:** *"There are nine factors the IRS generally uses in determining a taxpayer's profit motive. These factors are:*

- 1. The manner in which the taxpayer carries on the activity*
- 2. The expertise or experience of the taxpayer or taxpayer's advisors*
- 3. The time and effort expended by the taxpayer in carrying on the activity*
- 4. The expectation that the assets used in the activity may appreciate in value*
- 5. The success of the taxpayer in carrying on other similar or dissimilar activities*
- 6. The taxpayer's history of losses from the activity*
- 7. The amount of occasional profits earned from the activity*
- 8. The financial status of the taxpayer*
- 9. The elements of personal pleasure or recreation derived from the activity."*

## Gambling Winnings

Winnings from lotteries, raffles, horse races, poker tournaments and casinos, etc. are fully taxable. Gambling winnings, whether legal or illegal, are includible in gross income. Gambling winnings do not constitute a nontaxable return of capital, because the income is derived from the expenditure of time, energy, and skill rather than from the passive use of property.

For nonprofessional gamblers, wagering losses are itemized deductions, which means they are fully deductible only from adjusted gross income and only if the taxpayer forgoes the standard deduction. Professional gamblers, who pursue wagering as a full-time activity and not as a hobby, may treat their gambling losses as a trade or business expense, deductible from gross income to arrive at adjusted gross income. However, loss deductions for both professional and nonprofessional gamblers is limited to the amount of gambling gains, and excess losses and expenses cannot be carried over to other tax years. Gambling losses must be established by adequate evidence.

**MELISSA'S COMMENTS:** *"Payers must withhold tax from certain types of gambling winnings. Payments are subject to a 25 percent withholding rate. However, this rate is scheduled to sunset after 2010 when the withholding rate will then revert to a flat 28 percent. Taxes must be withheld from the following gambling proceeds:*

1. *State-conducted lotteries when the proceeds are over \$5,000;*
2. *Sweepstakes, wagering pools, and non-state conducted lotteries when the proceeds are more than \$5,000; and*
3. *Proceeds that are at least 300 times as large as the amount wagered in a pool for horse races and dog races."*



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**What's on Your  
Mind ...  
"TAXING"  
QUESTIONS**

Dear Colette and  
Melissa,

I've heard that a first-time homebuyer can withdraw funds from a Roth IRA to cover settlement costs when buying a home without being subject to a penalty.

My son currently bought an older home but has not withdrawn the dollars yet.

Providing the Roth IRA principal has been invested for at least five years and those dollars are at least the amount of the withdraw, can he withdraw all the settlement costs?

Can you please define what constitutes settlement costs? Can he withdraw these dollars anytime this calendar year?

*Thanks,  
Beth  
York, PA*

Dear Beth,

## CORPORATE TAX NEWS

### YEAR END TAX PLANNING - OPPORTUNITIES GALORE

As we head into the last quarter of 2009 let's reflect back on the American Recovery and Reinvestment Act of 2009 (ARRA) and discuss some of the provisions of this Act and how they may apply to you or your company. This law was signed by President Obama on February 17, 2009 and provided relief to both individuals and businesses. The provisions of this Act added many new tax breaks and significant enhancements to existing deductions and credits.



Tax Advisor  
Colette Brownson

The first-time home buyer credit has been one of the most utilized provisions of this Act over the last 12 months. The new enhancements of the ARRA apply to purchases of a principal residence by a first-time home buyer after December 31, 2008. Under these rules, a qualified first-time home buyer may be eligible to receive a tax credit up to \$8,000 when purchasing a home any time prior to November 30, 2009. The new provisions also eliminated any required repayment to the IRS after 36 months in the home. The credit phase-outs that start for taxpayers with AGI in excess of \$75,000 (\$150,000 for joint filers) continue to apply.

The new law also includes an alternative minimum tax (AMT) patch for 2009. The AMT patch raises exemption amounts slightly above the 2008 patch levels. These exemption amounts are: \$70,950 for joint filers and surviving spouses (up from \$69,950 in 2008); and \$46,700 for singles and heads of households (up from \$46,200).

A surprise provision in the ARRA allows purchasers of new vehicles for the rest of 2009 an above-the-line deduction for state and local sales taxes or excise taxes paid on the purchase. There are two limits on this new deduction: (1) deductible sales tax cannot exceed the portion of the tax attributable to the first \$49,500 of the purchase price of any one vehicle; and (2) any deduction will be phased out to the extent the purchaser has adjusted gross income exceeding \$125,000 (\$250,000 for joint returns). Any newly purchased vehicle, including cars, SUVs, light trucks, motorcycles, first used by the taxpayer that weighs no more than 8,500 gross pounds generally qualifies.

Currently, the unemployment benefits are included in a recipient's gross income for federal income tax purposes. The new law temporarily excludes up to \$2,400 of unemployment compensation from a recipient's gross income for 2009.

Qualified tuition program (aka "529 plan") distributions used to pay a

Yes, a taxpayer may withdraw up to \$10,000 to cover usual settlement costs for a first-time homebuyer.

The \$10,000 is a lifetime maximum. The IRS states the withdrawal may be used to buy, build, or rebuild a "first" home that is the principal residence of the individual, his or her spouse, or any child, grandchild, or ancestor of the individual or spouse.

Acquisition costs include any usual or reasonable settlement, financing, or other closing costs.

However, there is no clear definition of settlement costs; it will be the normal costs incurred at settlement.

The withdrawal from the taxpayer's Roth IRA must be used within 120 days of the date you withdrew the funds. Therefore, you must withdraw the funds before your settlement date.

*Until next month,  
Colette and Melissa*

If you have a general tax question you would like to have answered in a future edition, please email [mmyers@stambaughness.com](mailto:mmyers@stambaughness.com).

beneficiary's qualified education expenses are tax-free. Other distributions are included in the beneficiary's income and are subject to a penalty. For 2009 and 2010 the new law allows beneficiaries of qualified tuition programs to use tax-free distributions to pay for computers and computer technology, including internet access. As long as the student uses the technology, the new law allows other family members to use it without allocation.

The ARRA extends the 50-percent first-year bonus depreciation allowed under the 2008 Economic Stimulus Act through December 31, 2009. It also extends the increased 2008 Code Sec. 179 expensing (aka, small business expensing) amounts to 2009. More detailed information is discussed below in the "Need a Bonus in 2009?" article.

Certain businesses may also elect to recognize cancellation of indebtedness income over five years, beginning in 2014, for specified types of business debt repurchased by the business after December 31, 2008, and before January 1, 2011. An applicable debt instrument under the new law means a bond, debenture, note, certificate, or any other instrument constituting indebtedness issued by a C corporation with the conduct of a trade or business by such person.

The S corporation built-in gain period has been temporarily shortened by the ARRA. Under new provisions, the holding period for assets subject to the built-in gains tax imposed after a C corp elects to become an S corp has been shortened from 10 to 7 years. This reduction applies to C corps that convert to S corps in tax years beginning in 2009 and 2010.

For individuals with qualified small business income, estimated tax payments for tax years beginning in 2009 may be based on 90 percent of the prior year's tax liability. The individual must have AGI under \$500,000 and must certify that more than 50 percent of the gross income on his return for the prior tax year was from a small business.

**COLETTE'S COMMENTS:** "This article highlights only a few of the tax provisions from the American Recovery and Reinvestment Act of 2009. We recommend you consult with your tax advisor to determine if any of these may be applicable to you or your company. Also, now is a good time to ask if any of the additional provisions not mentioned in this article might be of benefit to you."

## PHILADELPHIA SALES TAX INCREASE

As mentioned in September's *Taxing Times*, Philadelphia has increased its local sales and use tax rate from 1% to 2%. The rate became effective on all transactions beginning October 8, 2009.

Therefore, all transactions taking place in Philadelphia are subject to a total state and local sales and use tax rate of 8%.

## NEED A BONUS IN 2009?

Now is a crucial time to revisit the provisions relating to bonus depreciation and Code Sec. 179 expense. Many businesses may be able to benefit from the use of these two tax provisions, so let's review the guidelines.

As mentioned above, the ARRA extended both the 50-percent first-year bonus depreciation allowance and the increased Code Sec. 179 expense of \$250,000 through December 31, 2009. These provisions will allow you to accelerate your depreciation deduction in the current year, effectively reducing taxable income in that year.

Generally, bonus depreciation can be taken on qualified property acquired after December 31, 2007 and placed in service before January 1, 2010, as long as the original use begins with the taxpayer. Qualified property includes property that has a recovery period of 20 years or less, off-the-shelf computer software with a three-year depreciation period, new water utility property and qualified leasehold improvement property. However, there are specific rules regarding the qualifications of leasehold improvement property.

In the case of any qualified property, the depreciation deduction for the taxable year in which such property is placed in service shall include an allowance equal to 50 percent of the adjusted basis of the qualified property. The adjusted basis of the property shall be reduced by the amount of this deduction before computing the amount otherwise allowable as a general depreciation deduction for such taxable year and any subsequent taxable year. Also, keep in mind the first-year depreciation cap for a vehicle subject to the luxury car caps is increased by \$8,000 if the 50 percent bonus depreciation deduction is claimed on a vehicle acquired after December 31, 2007 and placed in service before January 1, 2010. Any property that must be depreciated using the MACRS alternative depreciation system (ADS) in the year it is placed in service is not eligible for bonus depreciation.

The Section 179 expensing provision applies to tangible property which is acquired by purchase for use in the active conduct of a trade or business. The current provisions allow for expensing up to \$250,000 of qualifying purchases of new or used property subject to an \$800,000 threshold for deduction phase-out. Business placing property in service in 2010 will be confined to a \$125,000 maximum deduction with a \$500,000 cap.



**COLETTE'S COMMENTS:** *"Both of these provisions are great tax planning tools that are available to businesses in the 2009 tax year. It is important to note that for state purposes, you will need to check the rules*

*for the specific state you are filing in. Some states do adopt the federal guidelines regarding Sec. 179 expensing and bonus depreciation. However, a majority of states may have their own specific rules regarding these deductions."*

#### CONTACT US

For more information about any of these tax topics or other tax-related concerns, please contact our SNPC tax professionals, Colette or Melissa, at 717-757-6999/800-745-8233. You may also visit [our website](#) or reply to this email. Links to [past issues of "Taxing Times"](#) can also be found on our website.

