Last-Minute Tax Tips to Consider in Recessionary Times

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The troubled economy has prompted recent income tax law changes, creating unique tax savings opportunities for many individuals and businesses. Tried-and-true tax strategies also exist that are seldom available in a robust economy. With the tax filing season drawing to a close and final preparations underway to prepare and file 2008 tax returns, the following recommendations may benefit both last-minute filers and taxpayers filing extensions. Included are often-overlooked tax strategies, many of which having no income thresholds, with a particular focus on tax tips for individuals and businesses during difficult economic times.

Select Individual Strategies

Maximize the Tax Recovery of Madoff and Other Related Frauds. Victims of the Madoff and Madoff-like investment schemes have an opportunity to generate substantial income tax recoveries to partially offset their investment losses. Investors who have incurred losses may amend their tax returns for years 2005 through 2007 to recover tax paid on fictitious earnings and claim a theft loss in 2008. The theft loss calculation is complex, so you may want to consult your tax advisor if you are impacted. As recently announced by the IRS, investors can forego the amended tax returns and claim a theft loss in 2008 under a "safe harbor" procedure, which generally permits taxpayers to deduct in 2008 the full amount of their investment, on a tax cost basis, less the amount of any actual recovery in the year of discovery and the amount of any recovery expected from private or other insurance, such as that provided by the Securities Investor Protection Corporation (SIPC). The calculation under the "safe harbor" procedure is fairly straightforward. Under either the amended return or 2008 safe harbor approach, a theft loss is more valuable than an investment loss. A theft loss reduces ordinary income and can be carried back three and up to five years to recover taxes paid in earlier years. Unused theft losses can be carried forward 20 years. An investment loss can offset only capital gains, something not realized by most taxpayers in 2008, and cannot be carried back.

Claim Job-Hunting Expenses. Expenses incurred in seeking new employment in the same trade or business are deductible. A job seeker must be looking for employment in the same trade or business in which he or she is presently or formerly employed. Common deductible expenses include resume costs, including postage; job counseling and referral fees; employment agency fees; telephone charges related to seeking new employment; and local and out-of-town travel expenses incurred for interviews, to the extent not reimbursed by the prospective employer.

Consider Net Unrealized Appreciation Options. When leaving a job, you may want to closely examine the portfolio of your 401(k) plan. In the event you own appreciated company stock in your 401(k) (*i.e.*, stock trading significantly above your tax cost basis), you should consider utilizing the net unrealized appreciation rules. That is, instead of rolling your entire 401(k) balance over to an IRA, roll over all assets except for your company stock and distribute the stock into a taxable account. The cost basis of the stock would be subject to tax at ordinary income tax rates. However, in a later year when the stock is sold, you would pay tax on the appreciated value at capital gains rates that are much lower than the current ordinary income tax rate (and lower than the predicted higher rate likely under President Obama's administration).

Assess Home Office Expense Deductions. Employees and self-employed individuals may be eligible to claim home office deductions, provided certain conditions are satisfied. Taxpayers may deduct home office expenses if part of the home is used exclusively and regularly for business. Additionally, for employees, the business use must also be for the convenience of the employer. Deductible expenses include the allocable portion of many traditional personal and non-deductible expenses, such as insurance, utilities, repairs, maintenance and depreciation.

Claim Special Tax Treatment for Mortgage Forgiveness. Generally, debt forgiveness results in taxable income. However, taxpayers whose mortgage debt was partially or wholly forgiven in 2008 may qualify for special tax relief to exclude the debt forgiven from income. Under the Mortgage Forgiveness Debt Relief Act of 2007, up to $2 million of debt forgiven on a principal residence may be excluded from income. However, debt forgiven on second homes, rental property, business property, credit cards or car loans does not qualify under the new tax-relief provision.

Undo an IRA Conversion. Traditional IRAs converted to Roth IRAs in 2008 are taxable on the portion that represents a return of nondeductible contributions. This may yield the unintended consequence of propelling a taxpayer into a higher tax bracket. Additionally, certain tax credits that phase out at higher levels of adjusted gross income (AGI) may be lost as a result of the IRA-withdrawal. This may present an especially difficult burden for taxpayers who have suffered a job loss or significant investment losses. While bonuses, severance payments and other income items typically cannot be reversed, taxable Roth IRA conversions can be reversed. Through a mechanism known as "recharacterization," the conversion can be reversed and the Roth IRA converted back into a traditional IRA. Without the taxable income from the conversion, a taxpayer can avoid being taxed at a higher rate while preserving other tax deductions and credits. A taxpayer can always convert in a year when he or she will be in a lower tax bracket or when income and earnings are more stable.

Make a Deductible IRA Contribution, Even If Not Employed. As a general rule, deductible IRA contributions cannot be made unless taxpayers have wages or other earned income. However, an exception applies to couples with only one working spouse. For 2008, a deductible IRA contribution of up to $5,000 ($6,000 for taxpayers 50 and over) is allowed for the non-working spouse, even if the working spouse is covered by an employer-provided retirement plan, provided the couple's modified AGI does not exceed $159,000. To be deductible for the 2008 tax year, the IRA contribution must be made by April 15, regardless of whether an extension is filed.

Claim Tax Credit of Up to $8,000 for First-Time Homebuyers. "First-time" homebuyers who purchased a primary residence after April 8, 2008, may qualify for a tax credit equal to 10 percent of the purchase price up to $75,000. First-time homebuyers are taxpayers who have not owned a residence in the United States in the three years preceding the purchase. The credit is phased out for single and joint filers with AGI between $75,000 to $95,000, and $150,000 to $170,000, respectively. While the credit is refundable to the extent it exceeds a taxpayer's regular tax liability, it does not offset the Alternative Minimum Tax. Be aware that this credit is essentially an interest-free loan from Uncle Sam because it must be repaid over 15 years. The repayment period begins two years after the year the credit is claimed. Thus, repayment begins in 2010 for credits claimed in 2008 ($500 per year for taxpayers who claim the maximum credit). If the residence is sold before the credit is fully repaid, the balance is due in the year of the sale. However, if the profit on the sale is less than the credit amount outstanding, the amount due is limited to the amount of profit.

The 2009 American Reinvestment and Recovery Act increased the maximum credit from $7,500 to $8,000, eliminated the repayment provision (unless the home is sold within three years of purchase or otherwise ceases to be a primary residence) and allows taxpayers to treat homes purchased until November 30, 2009, as purchased on December 31, 2008, for purposes of claiming the credit on a 2008 tax return and for establishing the recapture period. First-time home buyers in 2009 can take advantage of this special provision now and obtain the credit, up to $8,000, on their 2008 tax returns, rather than wait until their 2009 returns are filed in 2010. Taxpayers who have already filed their 2008 returns may file an amended 2008 return to claim the credit. Finally, taxpayers who have not yet filed their 2008 returns but are buying a home soon can request an automatic six-month extension to file until October 15, to claim the credit on their 2008 tax returns. This would accelerate the benefit of the credit for taxpayers rather than having them wait until next year to claim it on their 2009 tax returns.

Claim a Moving Expense Deduction. Job-related moving expenses (the cost of moving household goods and personal effects plus transportation and lodging en route) are above-the-line deductions, and available to non-itemizers. This deduction is generally available only if: (1) the distance between a taxpayer's new job location and old home is at least 50 miles more than the distance between the old job location and former home and (2) the taxpayer works as a full-time employee at the new location for at least 39 weeks in the 12-month period following arrival (there is an exception for involuntary separation).

Claim Education Expense Deductions for Work-Related Expenses. Education costs that maintain or improve a taxpayer's business or employment skills may be deducted. However, costs incurred to meet the minimum requirements of a trade or profession, or to qualify one for a new job in a different field, are not deductible. "Education" does not have to be of the classroom variety and includes continuing education classes. For example, an unemployed attorney who hires a private consultant to train the attorney in an area outside the lawyer's current area of practice may still deduct the cost if it is an expense necessary to qualify for a new job opportunity within the legal profession. Therefore, an unemployed professional who has been employed within his field may generally deduct expenses for his education on the basis that it maintains or improves required skills within that profession. Additionally, expenses that are otherwise deductible will not be disallowed because the course of studies leads to a degree or certificate.

File Even If You Cannot Pay by April 15. Taxpayers unable to pay their tax liability in full, due to job losses or strained cash flow, should still timely file or extend their tax return. Failing to file will significantly increase penalties. Additionally, the IRS, generally a preferred creditor, will likely exercise its wide-reaching levy, lien, collection and seizure authority. If tax obligations are not paid timely and other payment arrangements are not made with the IRS, penalties will escalate, as will the risk of enforced collection efforts by the IRS along with the business and personal embarrassment that typically follows. In many cases, these situations can be avoided by meeting with a qualified and experienced tax professional and taking advantage of the best available alternatives. Options available to individuals and businesses confronted with this dilemma include the filing of a request for abatement of penalties, entering into a short- or long-term installment payment agreement and the filing of an offer in compromise.

Select Business Strategies

Employee Pay Can Help Write Off Business Equipment. A tax break for small businesses allows annual expensing of the cost of machinery and equipment up to $250,000 for 2008. Assets that are not expensed are depreciated over a period of years in accordance with their useful lives. However, the maximum annual amount that may be expensed is limited to the taxable income from the active trade or business for the year in which equipment is purchased and placed in service. If cash flow is negative, expensing is unavailable for that year. Fortunately, employee salaries are considered taxable income for expensing purposes. Therefore, if a business buys equipment, computers, printers, scanners, etc., the cost can be expensed, even if the business has not yet realized revenue, to the extent of employee salaries in that year. Therefore, the expensing deduction can essentially offset non-business income.

Accelerate the Deduction of Business Start-Up and Organizational Expenses. Start-up costs are expenses connected with setting up or investigating the creation or purchase of a trade or business and are incurred before the trade or business begins operation. Organizational costs include the costs of creating a corporation. Business start-up and organizational costs are not deductible and must be amortized. However, taxpayers may elect to deduct up to $5,000 of business start-up costs and $5,000 of organizational costs and amortize the remainder over 15 years. The $5,000 cap, however, is reduced by the excess of the total of start-up or organizational expenditures over $50,000 in the tax year in which the trade or business begins.

Maximize Net Operating Loss (NOL) Carrybacks. For any tax year beginning or ending in 2008, qualified small businesses with average gross receipts of $15 million or less may carry back NOLs three, four or five years. The election must be made by the due date of the return, including extensions. This may present a good opportunity for businesses to recover taxes paid in prior years when they were profitable but have incurred tax losses during the current economic downturn.

Claim an Often-Overlooked Deduction for Energy-Efficient Commercial Building Property. A special provision in the Internal Revenue Code, namely Section 179D, provides a tax deduction for owners who build energy-efficient buildings. Energy-efficient commercial building property is property that is: (1) depreciable or amortizable, (2) installed on or in a building located in the United States and (3) certified as being installed as part of a plan that will meet a 50-percent energy-use reduction test. In some situations in which the 50-percent test is not satisfied, a partial deduction is permitted. The property may be installed as part of a building's interior lighting systems; heating, cooling, ventilation and hot water systems; or the building envelope. The deduction can be meaningful.

These are but a few of the strategies you may wish to consider as you either prepare to complete your 2008 tax returns or finalize your extension calculations. In addition, there are items you may wish to consider as you plan for 2009, as the recently passed American Recovery and Reinvestment Act of 2009 may provide additional opportunities. You may also want to discuss the strategies included herein, or any tax-planning ideas, with a qualified tax professional prior to implementation.

For Further Information

If you have any questions regarding this article, please contact Michael A. Gillen, Director of the Tax Accounting Group, or Steven M. Packer, Manager in the Tax Accounting Group, or the practitioner with whom you are regularly in contact.

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