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Client Update

Table of Contents

New Housing Recovery Act Provides Major Tax...	Page 1
Protecting Your Home When Disaster Strikes	Page 2
Innocent Spouse Can't Recoup Payments...	Page 2
Gift Cards: Use 'em or Lose 'em	Page 2
The IRS' Kinder, Gentler Approach	Page 2
The IRS Interest Rates	Page 2

New Housing Recovery Act Provides Major Tax Incentives to Aid Real Estate Market & Businesses

On July 30, 2008, President Bush signed into law the Housing Economic Recovery Act of 2008, a measure designed to rescue the approximately 400,000 homeowners facing imminent foreclosure. The Act also contains \$15.1 billion in tax incentives to spur the troubled housing industry. In addition to many favorable breaks, the new law has revenue raisers that may adversely affect certain taxpayers. Here are the key provisions.

First-time homebuyer credit: To help homebuyers get over the hurdle of a down payment, the new law provides a refundable tax credit for the purchase of a principal residence. The credit is up to 10% of the purchase price of the home or \$7,500 (\$3,750 for taxpayers who are married filing separately), whichever is less. However, due to phase out provisions, the full credit cannot be claimed if the homebuyer's adjusted gross income in the year of purchase exceeds \$75,000 (\$150,000 on a joint return); the credit is phased out completely when AGI exceeds \$95,000 (\$170,000 for joint returns). The credit is really an interest-free loan from the government because it must be repaid in most cases. Repayment begins two years after the year of the purchase and is made ratably over 15 years. If the home is sold prior to the end of this recapture period or the homeowner stops using the home as a principal residence, the remaining amount is reported in full on the return for the year of sale (the recapture cannot exceed the gain from a sale to an unrelated party). Thus, if the full credit of \$7,500 is claimed for a home purchased in September 2008, \$500 must be added to the taxpayer's return starting in 2010. There is no

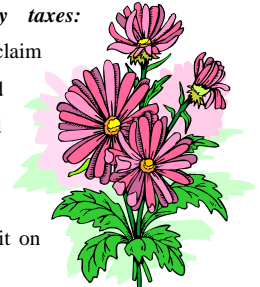


recapture if the homeowner dies, the home suffers an involuntary conversion and is replaced with another residence within two years, or the home is transferred to a spouse incident to a divorce (the transferee-spouse remains obligated to repay the credit amount). The credit applies only to homes purchased on

or after April 9, 0008, and before July 1, 2009.

Additional standard deduction for property taxes:

Homeowners who do not itemize deductions can claim an additional standard deduction for state and local real estate taxes. The additional standard deduction is the lesser of actual taxes paid or \$500 (\$1,000 for joint returns). This break applies only for 2008. There is no income limit on this additional deduction.



Low income housing tax credit: The ability of state and local housing agencies to issue credits has been expanded. Also, investors can use the low-income housing credit to offset the alternative minimum tax.

Private activity bonds: Interest on private activity bonds used for certain housing projects is not treated as a tax preference item for AMT purposes, as is the case for interest on other private activity bonds.

Reduced home sale exclusion: Currently, a homeowner can claim a full home sale exclusion to shield gain from the sale of a principal residence up to \$250,000 (\$500,000 on a joint return) as long as the home has been owned and used as a principal residence for at least two of the five years preceding the date of sale. Under the new law, starting in 2009, the gain attributable to "nonqualifying use" cannot be sheltered by exclusion. However, only nonqualifying use after 2008 is taken into account. Nonqualifying use includes use of the residence as a vacation home or rental property. It does not include temporary absences due to a change in employment, health, or unforeseen circumstances or while on qualified official extended duty with the armed forces, foreign service, or intelligence community. Also, the period of vacancy after moving from the principal residence is not considered nonqualifying use. The amount of gain allocated to periods of nonqualified use is the total gain multiplied by a fraction, the numerator of which is the aggregate periods of nonqualified use and the denominator of which is the total period of ownership of the home.

Merchant credit card transactions: Starting in 2011, financial institutions will report credit and debit card transactions to the IRS. This

information reporting rule also covers PayPal transactions.

J.K. Lasser's Monthly Tax Letter, September 2008.

Protecting Your Home When Disaster Strikes

Hurricanes, wildfires and other natural disasters serve as an all-too-frequent reminder of the need to be prepared and know the ropes. Some quick tips: Maintain an emergency fund by keeping enough money in a savings account to cover three to six months' worth of living expenses. Immediately after disaster strikes, contact your insurer or agent and find out what you have to do to get the claims procedure rolling. Sign up for government assistance if you live in a federal disaster area. You could get a grant from the Federal Emergency Management Agency of up to \$28,800 if you have uninsured losses on your primary residence (but not a second home). Also, consider a Small Business Administration loan, available to individual homeowners and renters, not just to businesses. You can borrow up to \$240,000 to repair or replace damaged property.

Kiplinger's Personal Financial Adviser, September 2008.

Innocent Spouse Can't Recoup Payments Made From Community Property

Generally, couples who file joint returns are jointly and severally liable for the tax on those returns. However, one spouse can be relieved of the tax obligation by requesting innocent spouse status. This requires showing that it would be unfair to hold the requesting spouse liable for tax attributable to the other spouse. In one recent case, a couple in a community property state filed joint returns for 1982, 1983 and 1984; these returns all understated their tax liabilities. The couple made tax payments on their debt over two decades from community property funds and \$2,485 from the wife's separate funds. In 1999, the wife requested innocent spouse relief (the couple remained married at the time). The IRS granted her innocent spouse relief in the amount of \$160,912 and agreed to refund her the \$2,485 payment made with her separate funds. The IRS refused to refund payments made from community property funds. A divided Tax Court agreed with the IRS and an appellate court affirmed. The couple, who lived in California, is subject to community property rules. In that state, all property acquired by a married person during the marriage generally is considered to be community property. Community property is liable for both joint debts of the couple and separate debts of one spouse, regardless of which spouse has the management and control of the property.

The statute granting innocent spouse relief specifically states that "any determination under this section shall be made without regard to community property laws" (Code Section 6015 (a)). The taxpayer argued that this statutory language



shows that Congress intended to preempt community property law for purposes of calculating refunds to innocent spouses. The IRS argued that the sentence only addresses its right to make a determination of innocent spouse status. The appeals court agrees. The statutory language about "any determination" relates to the determination of eligibility for innocent spouse relief, but not whether the innocent spouse is entitled to a refund. Refund eligibility is a separate question governed by the law of the state in which the spouse resides. Thus section 6015 (a) does not preempt community property law and the wife can't recoup tax payments made from community property.

J.K. Lasser's Monthly Tax Letter, September 2008.

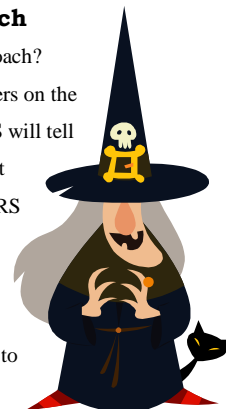
Gift Cards: Use 'em or Lose 'em

Delaying the use of a gift card could be a big mistake if the retailer that used it files for bankruptcy. Cards from Sharper Image, for example, are worthless; ditto for those of The Bombay Company. Although the assets of bankrupt companies are distributed to the firm's creditors, gift-card holders are unsecured creditors, whose claims come after banks and other secured creditors. Bankruptcy rumors are still swirling around Circuit City. Customers should redeem those cards pronto.

Kiplinger's Personal Financial Adviser, September 2008.

The IRS' Kinder, Gentler Approach

Think the IRS has given up on the kinder, gentler approach? Think again. It will put 31,000 suspected under-reporters on the honor system this fall, testing a pilot program. The IRS will tell them about discrepancies between 1099 forms and what was shown on their 2008 income tax returns. But the IRS will not ask for money. Instead, it will inform the recipients that they should either amend their income tax returns or have 1099 issuers correct any errors. Then, the IRS will check their 2009 income tax returns to see if the underreporting ceased. The goal of this pilot program is to reduce extensive correspondence over low dollar amounts. The IRS is hoping that the honor system approach is a cost-effective way of bringing tax scofflaws into line and not a pipe dream.



The Kiplinger Tax Letter, September 2008.

The IRS Interest Rates

The IRS interest rates are rising by a percentage point after September 30, 2008. On all overdue taxes, the IRS will charge 6%. For corporations that owe the IRS more than \$100,000 in back taxes, the interest rate will be 8%. On refunds, the IRS will pay 6% to individuals and 5% to corporations. However, for corporate refunds that exceed \$10,000 the rate on the excess is 3.5%.

The Kiplinger Tax Letter, September 2008.

