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NEWSLETTER

Carter Tax Incorporated Newsletter April 2009

Budget Reveals Possible Future Tax Scenarios

As you may already know President Barack Obama's tax policy objectives have changed. The tax cuts hoped for, are not a reality for most taxpayers. For example, the dire state of the economy dictated that President Obama's planned tax increases could not be implemented immediately.

But now, in the Administration's proposed budget for the government's 2010 fiscal year, some of Obama's longer-term tax policy goals have been disclosed.

They are listed below. Keep in mind these are only proposals. In order to become reality, they will have to be passed by both the Senate and the House of Representatives -- and some of these plans are already causing heated debates. But they can be useful as a long-term planning mechanism and as a guide to the thinking of the new Administration for tax planning.

BUDGET PROPOSALS AFFECTING BUSINESS

Repeal the LIFO Inventory Method.

In a controversial move, the Obama Administration wants to repeal the last-in-first-out (LIFO) method of calculating inventory costs for federal income tax purposes, starting in 2012. This time-honored method allows retailers and wholesalers to pay lower current taxes when inventory costs are rising due to inflation. Exactly how the repeal would be structured is not detailed in the budget. (See the table below to find out how much the U.S. Treasury will collect from the repeal.)

Reduce Tax Breaks for Oil and Gas Companies.

Reduce Tax Breaks for Oil and Gas Companies. The budget proposes to eliminate a number of tax breaks for oil and natural gas producers including (among others):

- The ability to immediately deduct intangible drilling costs.
- The percentage depletion deduction.
- The Section 199 domestic producers deduction.
- The exception to the passive loss limitation rules for losses from working interests in oil and gas properties.
- Quick write-offs for geological and geophysical costs.

These changes would begin in 2011.

BUDGET PROPOSALS AFFECTING INDIVIDUALS

Reinstate Higher Tax Rates on Higher-Income Individuals.

The proposed budget calls for ending the Bush tax cuts for those in the top two brackets starting in 2011. Specifically, the current 33 percent and 35 percent federal income tax rates would be replaced with the pre-Bush rates of 36 percent and 39.6 percent. According to the budget, this change would affect married joint-filing couples with incomes above \$250,000 and unmarried individuals with incomes above \$200,000.

Restore Deduction Phase-Out Rules for Higher-Income Individuals.

In addition to increasing the top two rates, the new Administration also wants to fully restore two phase-out rules that can eliminate:

- All of a higher-income taxpayer's personal exemption deductions and
- Up to 80 percent of most itemized deductions.

These changes would kick in starting in 2011 and would affect married joint-filing couples with incomes of more than \$250,000 and unmarried individuals with incomes above \$200,000. (Under current law, both of these phase-out rules are scheduled to disappear for 2010 and beyond.)

Reduce Itemized Deductions, Including Home Mortgage Interest and Charitable Donations for Higher-Income Individuals.

Starting in 2011, the proposed budget includes a change that would effectively allow only a 28 percent tax benefit for itemized deductions claimed by higher-income individuals who are in the new 35 percent and 39.6 percent tax brackets. So itemized deductions would first be subject to a phase-out rule, and whatever is left after the phase-out would deliver only a reduced tax-saving benefit.

This proposal is facing steep criticism from not-for-profit organizations and the real estate industry, which argue it will hurt charitable giving and home buying.

Apparently, this change would impact married joint-filing couples with incomes above \$250,000 and unmarried individuals with incomes above \$200,000.

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Increase Tax Rates on Capital Gains and Dividends. The Obama budget would leave the current taxpayer-friendly federal income tax rate structure on long-term capital gains and dividends in place for everyone except individuals who are in the highest two tax brackets. For them, the tax rate would be increased to 20 percent, up from the current 15 percent. This change would kick in starting in 2011 and would impact married joint-filing couples with incomes above \$250,000 and unmarried individuals with incomes above \$200,000.

Keep Applying the Alternative Minimum Tax "Patch." The budget proposes to continue the current policy of increasing the alternative minimum tax (AMT) exemption amounts each year to account for inflation.

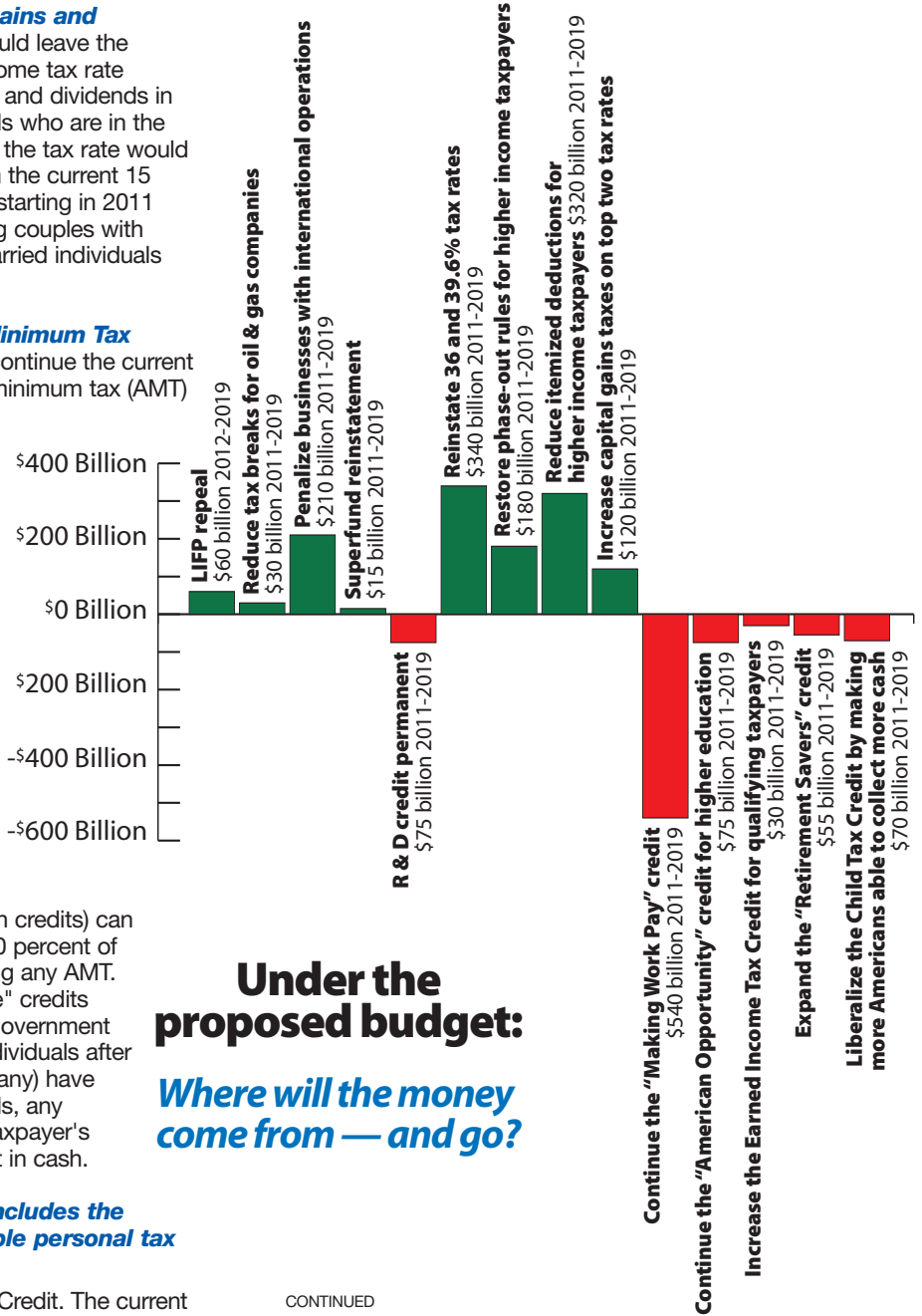
Keep the Current Estate Tax Rules. The budget calls for continuing the 2009 federal estate tax exemption amount of \$3.5 million per person and the current maximum estate tax rate of 45 percent.

(Republicans are pushing for a higher exemption and a lower tax rate.)

Give More Tax Credit Cash to Some Taxpayers. As you may know, most nonrefundable personal federal income tax credits (such as the child credit and the higher education credits) can currently be used to offset up to 100 percent of your federal income tax bill, including any AMT. But that's it. In contrast, "refundable" credits have that description because the government pays them out in cash to eligible individuals after their federal income tax liabilities (if any) have been reduced to zero. In other words, any refundable credits left over after a taxpayer's liability has been fully offset are sent in cash.

The Obama budget document includes the following proposals for refundable personal tax credits:

- Continue the "Making Work Pay" Credit. The current refundable credit of up to \$400 for working singles



Under the proposed budget:
Where will the money come from — and go?

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and up to \$800 for working couples would be continued. This credit was put in place for 2009 and 2010 by the American Recovery and Reinvestment Act of 2009 (also called the Stimulus Law).

- Keep the American Opportunity Credit in Place. The current partially refundable credit of up to \$2,500 to cover qualified higher education expenses during the first four years of college would be continued through 2019. This credit was created for 2009 and 2010 by the Stimulus Law.
- Liberalize the Earned Income Credit. The Obama budget calls for continuing the Stimulus Law's liberalizations of the refundable earned income tax credit. These changes provide increased credits to qualifying married joint-filing couples and to qualifying families with three or more children.
- Modify the Retirement Savers Credit. Under current law, this credit is for taxpayers with modest incomes who make eligible contributions to an employer-sponsored retirement plan or to an IRA. Under the proposed budget, the credit would be expanded to include more taxpayers, although the maximum amount of the credit would be apparently less. Also, the credit would be made refundable.
- Liberalize the Child Credit. The budget plan would continue the Stimulus Law's liberalizations of the child credit, which make it a wholly or partially refundable tax credit for more taxpayers.

Based on all the tax proposals being discussed right now, it's a good idea to start tax planning early, and to plan for that financial impact the future legislation could have on you and your business.



Can Your Company Win a Stimulus Government Contract?

Pursuing government contracts can be a long, costly and bureaucratic process. But with billions of dollars of stimulus money being awarded in a tough economy, many companies are looking at government contracts as a source of income.

Here are some considerations:

- Find out if any government agencies are buying services or products that your company provides by going to the "Federal Business Opportunities" Web site. By visiting www.fedbizopps.com, you can search government-wide contracting opportunities. The site lists major Federal government solicitations, contract awards, subcontracting opportunities, surplus property sales and foreign business opportunities. FedBizOpps is where Federal government agencies announce proposed contracts.
- If your company hasn't been involved in government contracting, it can be easier to break in by becoming a subcontractor or teaming up with another company that is familiar with the bidding process. Keep in mind there is a great deal of paperwork involved in pursuing federal government business. It generally begins with filing a 7-page form with the Central Contractor Registry (CCR). The registration form asks for detailed information about your company, identification numbers (such as a taxpayer ID number and a DUNS number from Dun Bradstreet) as well as classification codes for your products or services.
- Contact your accounting or law firm to see if it provides services to help companies navigate the federal (as well as state and local) government contracting world.

