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TAX SEASON LESSONS: Confusion, complexity mark season

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Gov't stimuli and a tough economy made the 2009 tax season unusual

Taxpayers feeling the pinch of the down economy made this tax season atypical of those in recent years, say practitioners.

In addition to taxpayers "harvesting" losses they suffered in the downturn, congressional actions to stimulate the economy added to the usual complexity.

In 2008, Congress created a $7,500 refundable tax credit for first-time homebuyers. Congress increased that credit to a maximum of $8,000 in February 2009.

Adding to this season's complexity was the Economic Stimulus Act of 2008, which resulted in more than 119 million payments totaling more than $96 billion. Most individuals received the stimulus payment in advance of filing their 2008 tax return based on information from their 2007 return, while some individuals who qualified for a larger payment received a Recovery Rebate Credit on their 2008 return.

"There was some confusion among taxpayers," revealed Rochester, N.Y.-based CPA Ellyn A. Schaefer. "Everybody that came in was nervous about their taxes. They wanted to know what was happening with the legislation that was pending in Congress. The general theme was unrest and unease. I've never experienced so much political talk at tax time."

"Some of our clients had a hard time dealing with their losses," explained Kara Cefalo, a tax partner in the Boston-based firm of DiCicco, Gulman & Co. "They were afraid to deal with it, so they came in later than usual."

"Their tax bills went down for the wrong reason," added Joel Rothenberg, also a partner at DiCicco.

Schaefer had two clients that qualified for the increased homebuyer credit. "One of them was aware of the credit, but the other hadn't heard of it," she said. "But a taxpayer who acquired ownership of the residence as part of a divorce was not qualified for the credit because she acquired it from a related party."

Normally, clients take a week off to coincide with their school-age children's spring break, which usually adds to the disorder of tax season, said Schaefer. "However, this year spring break was the week after April 15, so it helped make things flow more smoothly," she said.

RATE HIKES

Jonathan Wittlin, CPA, a senior vice president at Lenox Advisors, said that the economy and proposed changes in the Tax Code impacted tax season in several ways. "There's going to be a tax rate increase. Our top tax bracket is now 35 percent, but it will likely roll back to the pre-Bush rate of 39.6 percent, with an increase in the capital gains rate as well. Because of these likely increases, our conversation with clients about strategy was flipped," he said. "Normally, we talk about taking deductions now and pushing income into a future year. This year we talked with them about trying to pull income into the current year. Any item that would be a deduction for the current year we tried to push off into the future."

Wittlin noted that a number of his clients had deferred compensation, but were thinking of deferring a much smaller portion of it. "This would have sounded irrational two or three years ago, but if you can get a 4.6 percent discount, it's better to pay tax this year, rather than later when rates go up," he said.

"There were a lot more clients with a $3,000 loss on the front of their returns because they offset all of their gains and had the carryforward," said Greg Rosica, a tax partner at Big Four firm Ernst & Young. "Most of our clients don't get their returns done by April 15. We put them on extension until the Schedule K-1s and other information comes in."

"Changes in dividend policy had an effect on income in 2008 and even more in planning for 2009 in projections and estimated tax payments," he said.

Rosica noted that the lower interest rates presented an opportunity to do different types of wealth-transfer planning during tax season conversations.

"It can be something as simple as lending money to family members to use for investment strategies, or creating [grantor retained annuity trusts] or sales to defective trusts," he said. "With decreased values in a lot of client investments and lower interest rates, it's a perfect storm for planning."

Lenox Advisors' Wittlin agreed: "Asset values that are depressed, combined with the low interest rates, make GRATs more attractive. The idea is to take an asset with the potential for high appreciation and put it into the GRAT. You get any appreciation out of the estate, and any growth above 2.4 percent [the current Code Section 7520 interest rate] during the term of the GRAT remains in the trust and should have zero gift tax, if it's structured properly," he said. "Of course, one of the catches is that it's only valid if you outlive the term of the trust."

Tax season was easier this year as a result both of lower interest rates and the fact that many of his clients had capital losses instead of capital gains, observed Mike Solomon, partner-in-charge of the Tax Department at the Philadelphia office of Amper, Politziner & Mattia. "When we started doing extensions, many of our clients had overpaid their estimated tax," he said. "It wasn't necessary to figure out the tax due with extensions because we knew the client had overpaid during the first three quarters before the economy went into the tank."

THE PAPERLESS TAX OFFICE

Technology played a role in easing the load of tax season, explained Solomon.

"Our office has become virtually paperless for the tax return process," he said. "It gives us efficiencies we didn't have before. We didn't have to worry about misplaced paper because everything was scanned into the system, and our software is Internet-based. The only caution is you have to have everyone comply with office policies or the system breaks down."

Dave Shantz, tax practice leader at cbiz, likewise attributed his firm's smooth tax season to technology. "We have been paperless from the workpaper standpoint for many years," he said. "This year, we used a workflow product which scanned information at the front end and came back with an organized workpaper file and a return that was populated. The information goes directly from scan to review by the manager without having a staff person touch it."

DiCicco & Gulman's Tax Department also used an automated workflow system that helped smooth over the rough spots during tax season, according to Cefalo and Rothenberg. "The workflow system and our scheduling department matched up the appropriate staff with the level of work," explained Cefalo.

A bonus of the smoother workflow was less stress on preparers, Shantz noted: "People were healthier during tax season, and that made the whole staff more productive."