

Big Changes Coming With TY 2009 Returns

Key Credits & Deductions to Watch For

In February 2009, massive changes were made to the tax law with the passage of the 2009 American Recovery and Reinvestment Act (ARRA). Although headlines focused on benefits to large financial institutions, many of the credits and deductions instituted apply directly to average taxpayers and small businesses.

Now that tax season is approaching, it's a good idea to review the changes set forth by ARRA. Though your tax software will automatically apply many of these changes based on your clients' financial information, you'll want to discuss with your clients the opportunities and tax benefits that are available.

Incentives for Individuals

Making Work Pay Credit

The Making Work Pay Credit, a refundable income tax credit for 2009 and 2010, is the lesser of (1) 6.2% of the individual's earned income, or (2) \$400 (\$800 for married filing jointly, or MFJ). This credit is available, in full, to workers with a modified AGI of up to \$75,000 (\$150,000 for MFJ). Above that amount, the credit is phased out at a 2% rate. The credit applies to self-employment earnings to the extent that they're considered in computing taxable income.

Be aware that the Making Work Pay Credit does not apply to any individual whose tax return does not include a Social Security Number.

Your clients may already be benefitting from the Making Work Pay Credit, which is handled differently from prior stimulus programs in that it isn't automatically distributed via a one-time check, but as reduced wage withholdings. For most W-2 employees, employers are already having the withholdings adjusted automatically. (The employer's share of FICA (or its 6.2% equivalent) remains unchanged). Alternately, taxpayers can take the credit as a lump sum when filing their annual tax return.

Schedule M, Making Work Pay, and Government Retiree Credits, should be included with the individual tax return, regardless of how the taxpayer takes the credit. Most tax software programs will automatically calculate Schedule M for you.

Economic Recovery Payment

Certain fixed-income individuals (such as disabled veterans, railroad retirees, Social Security recipients, and certain government workers) are receiving a one-time recovery payment of \$250 in 2009. If the individual receives both this payment and the Making Work Pay Credit, the Making Work Pay Credit will be reduced by the \$250 payment.

First-Time Homebuyer Credit

The First-Time Homebuyer Credit, a 2008 credit that has been widely publicized by real estate firms, was extended and changed for 2009. For home purchases made after December 31, 2008, the credit has been raised to \$8,000 (from \$7,500) and extended to November 30, 2009. Any required repayments to the IRS are eliminated after 36 months in the home.

As with the previous homebuyer credit, the taxpayer (1) has to have purchased the primary residence during the current calendar year, and (2) cannot have owned a residence in the U.S. during the previous three years. A taxpayer who bought a home on or after April 9, 2008, and before January 1, 2009, does not qualify for the 2009 homebuyer credit; the purchase will continue to be governed by the original 2008 credit.

Phase-outs apply for both 2008 and 2009 and begin for individuals with AGI greater than \$75,000 (\$150,000 for MFJ) for the year of purchase.

To claim the credit, use Form 5405 to claim the First-Time Homebuyer Credit.

Temporary Tax Deduction on Car Purchases

This benefit is actually an above-the-line deduction for the state sales taxes, local sales taxes, and excise taxes paid by a purchaser of a new vehicle. To qualify, a taxpayer must have purchased the vehicle for first use between February 17 and December 31, 2009. The vehicle must be either (1) a passenger vehicle, light truck, or motorcycle with a gross weight of no more than 8,500 pounds, or (2) a motor home. Deductible taxes can't exceed the portion attributable to the first \$49,500 of the price paid for any single vehicle. Phase-outs start for individuals with AGI greater than \$125,000 (\$250,000 for MFJ).

For taxpayers taking the standard deduction, this credit should be claimed on Schedule L, Standard Deduction for Certain Filers. For itemizers, use Schedule A, Itemized Deductions.

American Opportunity Tax Credit

The American Opportunity Credit is a reworking of the Hope Credit and has been enhanced in the following ways under ARRA:

- Amount increased to a maximum of \$2,500 (from \$1,800) per eligible student per year
- Modified rate of 100% of the first \$2,000; 25% of the next \$2,000, with a maximum \$2,500 per year allowed on \$4,000 in qualifying payments
- 40% of the credit is refundable for 2009 and 2010
- Applies for all four years of college
- Qualifying expenses include course materials

The credit can be claimed by either a non-dependent taxpayer student or a parent of a qualifying student. Along with the changes listed above, the phase-out level for claiming the credit has increased to \$80,000 AGI (\$160,000 for MFJ).

The American Opportunity Credit is claimed using Form 8863, Education Credits.

Qualified Tuition Programs ("529 Plans")

Changes in qualifying expenses have been made to tax-free college savings plans for 2009 and 2010. A beneficiary of a qualified tuition program can now use distributions to pay for computers and computer technology (including Internet). Distributions are tax-free. (Previously, these expenses were not tax-free, were included in the beneficiary's income, and were subject to penalty.)

Earned Income Credit (EIC)

For 2009 and 2010, EIC percentage is increased to 45% of the first \$12,750 of earned income for taxpayers who have three or more qualifying children. (Prior to the new law, the credit was 40% of this amount for taxpayer with two or more qualifying children.) Several forms will be modified to account for the third child: Form 8867 (Paid Preparer's Earned Income Checklist), Form 8862 (Information To Claim EIC After Disallowance), and Schedule EIC (Earned Income Credit).

In addition, the EIC phase-out range has been adjusted upward by \$1,880 to eliminate any marriage penalty for joint filers.

Changes to Criteria for a Qualifying Child for EIC

The following changes do not result from ARRA, but from the Fostering Connections to Success and Increasing Adoptions Act of 2008. They are effective for tax years beginning after December 31, 2008.

- The qualifying child must be younger than the taxpayer claiming the child.
- The qualifying child must not have filed a joint return other than for a claim of refund.
- A taxpayer other than the parents of a qualifying child is allowed to claim the child, but only if the taxpayer's AGI is higher than the highest AGI of any parent of the child.

Form 8867 will be updated to reflect these additional qualifying child criteria for EIC.

Child Tax Credit

In another child-related credit, the refundable part of the Child Tax Credit is increased for 2009 and 2010. The income threshold is now set at \$3,000 (down from \$8,500). The full credit amount is still \$1,000.

Unemployment Compensation

Generally, a taxpayer's gross income must include all unemployment compensation benefits received. In 2009 only, up to \$2,400 of unemployment compensation is excluded from gross income for federal income tax purposes.

Transit Benefits

Transit passes, van pooling, qualified parking, and other qualified transportation fringe benefits are not typically included in employee income up to a certain dollar amount. In March 2009, this dollar amount was increased to \$230 per month (up from \$120) for transit passes and van pooling. This increased exclusion will continue through 2010 with adjustments made for inflation.

AMT Patch

Under ARRA, the Alternative Minimum Tax (AMT) patch for 2009 features the following exemption amounts:

- For joint filers and surviving spouses: \$70,950 (up from \$69,950)
- For singles and heads of households: \$47,200 (up from \$46,200)
- For married filing separate filers: \$35,475 (up from \$34,475)

Other Incentives for Individuals

- Property Tax Deduction – Allows homeowners up to \$500 deduction (\$1,000 for MFJ) of property taxes, with no itemizing required
- Teacher Expense Deduction – Allows educators a \$250 deduction for out-of-pocket educational expenses, with no itemizing required
- Charitable Giving from IRAs – Allows transfer of up to \$100,000 from tax-deferred retirement account to a qualified charity. Generally available to 70+ taxpayers who can make such transfers without penalty. Donation counts as a minimum distribution (cannot be deducted).

Energy Incentives

Residential Energy Property Credit

This credit is allowed for eligible property placed in service in 2009 or 2010, with the following modifications to the pre-2008 credit:

- Increase of residential energy property tax credit to 30% (from 10%)
- Increase of maximum cap to \$1,500 aggregate amount for 2009 and 2010 installations
- Elimination of the \$500 lifetime cap

Residential Energy-Efficient Property Credit

Modifications include removal of individual dollar caps under credit regulations for solar hot water property, geothermal heat pumps, and wind energy property. In addition, a \$500 credit cap is placed on all qualified fuel cell property expenditures.

Renewable Electricity Production Credit

This credit applies for electricity produced from wind and other renewable sources. ARRA extends the placed-in-service dates for qualified facilities under Code Sec. 45 through 2012 for wind facilities, and through 2013 for most other facilities.

Investment Credit Election

Instead of producers taking the Code Sec. 45 production credit, taxpayers can treat certain alternative energy facilities as energy property eligible for a 30% investment credit under Code Sec. 48, which can be coordinated with renewable energy grants.

Alternative Fuel Pump Tax Credit

For commercial and retail stations, credit for alternative fuel vehicle refueling property is increased to 50% (\$50,000 cap) of the cost of property that was placed in service by the taxpayer at each location in 2009 and 2010. For individuals, the credit is increased to 50% (\$2,000 cap).

Energy Investment Credit

ARRA removes the credit cap for small wind energy property under Code Sec. 48 energy investment property. A taxpayer may be able to take a 30% credit for certain small wind energy property expenses made during the tax year.

Plug-in Electric Vehicles

An existing credit for plug-in vehicles has been modified, with separate treatment for low-speed vehicles. The credit's base amount is \$2,500; the full amount will be reduced once the manufacturer records its 200,000th sale of these vehicles, which are not yet on the market.