

2009 Year End Tax Planning Information

Individual Tax Law Changes for 2009:

“Making Work Pay” credit. The new law provides an individual tax credit in the amount of 6.2% of earned income not to exceed \$400 for single returns and \$800 for joint returns in 2009 and 2010. The credit is phased out at adjusted gross income (AGI) in excess of \$75,000 (\$150,000 for married couples filing jointly). The credit can be claimed as a reduction in the amount of income tax that is withheld from a paycheck, or through a credit on a tax return. Under the credit, workers can expect to see perhaps \$13 a week less withheld from their paychecks starting around June. Next year, the extra take-home pay will go down to around \$7.70 per week.

Economic recovery payment. The new law provides for a one-time payment of \$250 to retirees, disabled individuals and Social Security beneficiaries and SSI recipients receiving benefits from the Social Security Administration and Railroad Retirement beneficiaries, and to veterans receiving disability compensation and pension benefits from the U.S. Department of Veterans' Affairs. The one-time payment is a reduction to any allowable Making Work Pay credit.

Refundable credit for certain federal and state pensioners. The new law provides a one-time refundable tax credit of \$250 in 2009 to certain government retirees who are not eligible for Social Security benefits. This one-time credit is a reduction to any allowable Making Work Pay credit.

Unemployment compensation exclusion. A provision temporarily suspends federal income tax on the first \$2,400 of unemployment benefits received by a recipient in 2009.

Expanded earned income tax credit. The new law provides tax relief to families with three or more children and increases marriage penalty relief. The changes apply for 2009 and 2010.

Expanded child tax credit. A measure increases the eligibility for the refundable child tax credit in 2009 and 2010 by lowering the earned income threshold to \$3,000 (from \$8,500 in 2008).

Expanded and revised higher education tax credit. The new law creates a \$2,500 higher education tax credit that is available for the first four years of college. The credit is based on 100% of the first \$2,000 of tuition and related expenses (including books) paid during the tax year and 25% of the next \$2,000 of tuition and related expenses paid during the tax year, subject to a phase-out for AGI in excess of \$80,000 (\$160,000 for married couples filing jointly). 40% of the credit is refundable. The new credit temporarily replaces the Hope credit.

Computers as an education expense. A provision permits computers and computer technology to qualify as qualified education expenses in 529 education plans for tax years beginning in 2009 and 2010.

Expanded credit for first-time home buyers. Last year, Congress provided taxpayers with a refundable tax credit that was equivalent to an interest-free loan equal to 10% of the purchase of a home (up to \$7,500) by first-time home buyers. The provision applied to homes purchased on or after April 9, 2008 and before July 1, 2009. Taxpayers receiving this tax credit were required to repay any amount received under this provision back to the government over 15 years in equal installments (or earlier if the home was sold). The credit phases out for taxpayers with AGI in excess of \$75,000 (\$150,000 in the case of a joint return). The new law enhances the credit by eliminating the repayment obligation for taxpayers that purchase homes on or after January 1, 2009. It also extends the credit through the end of November 2009, and bumps up the maximum value of the credit from \$7,500 to \$8,000.

First-Time Homebuyer Credit Extended to April 30, 2010; Some Current Homeowners Also Qualify. A new law that went into effect Nov. 6 extends the first-time homebuyer credit five months and expands the eligibility requirements for purchasers.

The Worker, Homeownership, and Business Assistance Act of 2009 extends the deadline for qualifying home purchases from Nov. 30, 2009, to April 30, 2010. Additionally, if a buyer enters into a binding contract by April 30, 2010, the buyer has until June 30, 2010, to settle on the purchase. The maximum credit amount remains at \$8,000 for a first-time homebuyer — that is, a buyer who has not owned a primary residence during the three years up to the date of purchase.

But the new law also provides a “long-time resident” credit of up to \$6,500 to others who do not qualify as “first-time homebuyers.” To qualify this way, a buyer must have owned and used the same home as a principal or primary residence for at least five consecutive years of the eight-year period ending on the date of purchase of a new home as a primary residence.

For all qualifying purchases in 2010, taxpayers have the option of claiming the credit on either their 2009 or 2010 tax returns.

A new version of Form 5405, First-Time Homebuyer Credit, will be available in the next few weeks. A taxpayer who purchases a home after Nov. 6 must use this new version of the form to claim the credit. Likewise, taxpayers claiming the credit on their 2009 returns, no matter when the house was purchased, must also use the new version of Form 5405. Taxpayers who claim the credit on their 2009 tax return will not be able to file electronically but instead will need to file a paper return.

A taxpayer who purchased a home on or before Nov. 6 and chooses to claim the credit on an original or amended 2008 return may continue to use the current version of Form 5405.

Income Limits Rise. The new law raises the income limits for people who purchase homes after Nov. 6. The full credit will be available to taxpayers with modified adjusted gross incomes (MAGI) up to \$125,000, or \$225,000 for joint filers. Those with MAGI between \$125,000 and \$145,000, or \$225,000 and \$245,000 for joint filers, are eligible for a reduced credit. Those with higher incomes do not qualify.

For homes purchased prior to Nov. 7, 2009, existing MAGI limits remain in place. The full credit is available to taxpayers with MAGI up to \$75,000, or \$150,000 for joint filers. Those with MAGI between \$75,000 and \$95,000, or \$150,000 and \$170,000 for joint filers, are eligible for a reduced credit. Those with higher incomes do not qualify.

New Requirements. Several new restrictions on purchases that occur after Nov. 6 go into effect with the new law:

Dependents are not eligible to claim the credit.

No credit is available if the purchase price of a home is more than \$800,000.

A purchaser must be at least 18 years of age on the date of purchase.

For Members of the Military. Members of the Armed Forces and certain federal employees serving outside the U.S. have an extra year to buy a principal residence in the U.S. and still qualify for the credit. An eligible taxpayer must buy or enter into a binding contract to buy a home by April 30, 2011, and settle on the purchase by June 30, 2011.

Sales Tax Deduction for New Vehicles. Buyers of new vehicles can deduct the sales tax paid on the purchase, even if they don't claim sales taxes as itemized deductions. They can add the tax they pay to their standard deduction. This break applies to new cars, motor homes, light trucks and motorcycles purchased after February 16, 2009 and before January 1, 2010. Sales tax paid on the first \$49,500 of cost qualifies.

The benefit begins phasing out for married couples with AGI over \$250,000 and singles with Adjusted Gross Income over \$125,000. It is completely gone for single filers with Adjusted Gross Income of \$135,000 or more, or joint filers with AGI of at least \$260,000.

Itemizers who elect to deduct state sales taxes in lieu of state income taxes get no benefit from this change, since the auto sales tax is already included in the sales tax deduction. Itemizers who deduct state income taxes will get a separate deduction for auto sales taxes; non-itemizers will add the sales tax amount to their standard deduction amount.

Alternative minimum tax (AMT) patch. To hold the number of taxpayers subject to the AMT at bay, the new law increases the AMT exemption amounts for 2009 to \$46,700 for unmarried individuals, to \$70,950 for joint returns, and to \$35,475 for married individuals filing separate returns, and allows the personal credits against the AMT.

COBRA premium assistance. Individuals laid off from their jobs between September 1, 2008 and December 31, 2009 meeting income limits may qualify for nine months of COBRA premium assistance under the 2009 Recovery Act. Individuals pay 35 percent of the COBRA premium and employers must treat that as full payment. Employers claim a credit for the other 65 percent of the premium on their payroll tax returns.

Charitable contributions. The timing of charitable contributions can have an important impact on year-end tax planning. Note that for 2009 (but not for 2010, unless Congress extends this tax break), individual taxpayers who are *at least 70 1/2 years old* may contribute to charities directly from their IRAs without having the amount of their contribution included in their gross income. By making this move, some taxpayers may be able to reduce their tax liability even more than they would have if they had received the distribution from their IRA and then contributed the amount distributed to charity.

Larger Personal Exemptions. For 2009, each personal exemption you can claim is worth \$3,650, up by \$150 from 2008.

Higher Standard Deductions. For 2009, the standard deduction for marrieds filing a joint return rises to \$11,400, up by \$450 from 2008. Joint filers can also add in up to \$1,000 of property taxes paid. For single filers, the amount increases to \$5,700 in 2009, up by \$250 over 2008. Singles can also deduct up to \$500 of real estate tax payments. Heads of household can claim \$8,350 in 2009, a jump of \$350 from 2008. Non-itemizers who pay real estate taxes can claim even larger standard deductions. Non-itemizers can also add any casualty losses that occurred in presidentially-declared disaster areas.

Higher Income Limits for Deductible IRAs and for Roth IRAs. If you are covered by a retirement plan at work, you can take a full IRA deduction in 2009 if your modified Adjusted Gross Income is less than \$89,000 (married filing jointly) or \$55,000 (single or head of household). A partial deduction is allowed until your Adjusted Gross Income reaches \$109,000 if you are married filing jointly, or \$75,000 if you are single or a head of household. Also, the opportunity to contribute to a Roth IRA is now phased out as your modified Adjusted Gross Income rises between \$166,000 and \$176,000 if you are married filing jointly, or \$105,000 to \$120,000 if you are single or a head of household.

Increased Contribution Limit for 401(k) Plans. The maximum employee contribution rises to \$16,500 from \$15,500 in 2009 for these and similar workplace retirement plans, including 403(b)s and the federal Thrift Savings Plan. Workers age 50 and older in 2009 can put in an additional \$5,500 this year, also a \$500 increase from 2007. Thus, their maximum contribution is \$22,000.

Federal Estate Tax Exemption. In 2009, the federal estate tax exemption rises to \$3,500,000 from its 2008 level of \$2,000,000.


Higher Annual Gift Tax Exemption. For 2009, you can give any individual up to \$13,000 without owing any gift tax, a \$1,000 increase over 2008.

Reduction in Itemized Deductions and Personal Exemptions for High-Income Taxpayers. As noted earlier, itemized deductions and personal exemptions are phased out as your income rises. In 2009, the reductions are a bit less painful. The cutback in itemized deductions occurs once your Adjusted Gross Income exceeds \$166,800, regardless of your filing status. Your itemized deductions are reduced by 1 percent of the amount by which your AGI exceeds \$166,800, but you can never lose more than 80 percent of your itemized deductions. Also, your medical expenses, investment interest deduction, deductible gambling losses and any casualty and theft losses are not subject to the cut. Personal exemptions are reduced by 2 percent for each \$2,500 of Adjusted Gross Income over \$250,200 for married filing jointly, \$208,500 for heads of households and \$166,800 for singles, but the reduction cannot exceed \$1,217 per exemption.

Converting a Second Home to a Primary Home. If you convert a second home into a principal residence after 2008, you may not be able to exclude all of your gain. A portion of the gain on a subsequent sale of the home will be ineligible for the home-sale exclusion of up to \$500,000, even if the seller meets the two-year ownership-and-use tests. The portion of the profit that's subject to tax is based on the ratio of the time after 2008 when the house was a second home or a rental unit, to the total time you owned it. So if you have owned a vacation home for 18 years and make it your main residence in 2011 for two years before selling it, only 10 percent of the gain (two years of nonqualified second home use divided by 20 years of total ownership) is taxed. The rest qualifies for the home-sale exclusion of up to \$500,000.

Nonbusiness Energy Property Credits. These credits are available for energy-saving home improvements. Recent tax law changes have made taking the *Nonbusiness energy property credit* (Code Sec 25C) and the *Residential energy efficient property credit* (Code Sec 25D) in 2009 more valuable than ever from a tax standpoint. In Congress's efforts to encourage energy conservation, both the *Emergency Economic Stabilization Act of 2008 (EESA)*, enacted in late 2008, and the *American Recovery and Reinvestment Act of 2009 (ARRA)*, enacted in early 2009, have increased, broadened, and liberalized these credits.

Changes to the Nonbusiness energy property credit. EESA made a number of changes to the Code Sec 25C credit. Among them, EESA extended the tax credit for 2009.

 **Observation:** The credit, which had expired for property placed in service after Dec. 31, 2007, was extended for property placed in service after Dec. 31, 2008 and before Jan. 1, 2010.

It included energy-efficient biomass fuel stoves as a new class of energy-efficient property eligible for the credit. This is a stove that burns biomass fuel to heat a dwelling unit located in the U.S. that the taxpayer uses as a residence, or to heat water for use in the residence, and that has a specified thermal efficiency rating. Biomass fuel means any plant-derived fuel available on a renewable or recurring basis, including agricultural crops and trees, wood and wood waste and residues (including aquatic plants), grasses, residues, and fibers.

It also added asphalt roofs with appropriate cooling granules as an item that qualifies for the credit.


ARRA made additional changes to the Code Sec 25C credit. Among them,


- extended the credit for an additional year, through 2010.
- raised the 10% credit rate to 30% for property placed in service before 2011.

- replaced the previous \$50, \$150, and \$300 credit limits on certain property and the \$500 lifetime cap (\$200 lifetime cap for windows) with an aggregate cap of **\$1,500** for property placed in service *after 2008 and before 2011, and*

- it eliminated the limitation on subsidized energy financing in determining amounts that could qualify for the credit.

*The present day **Nonbusiness Energy Property Credit**.* For property placed in service in tax years beginning after 2008 and before 2011, a taxpayer can claim (on Form 5695) a credit equal to 30% of the sum of the cost of: qualified energy efficiency improvements to his home and residential energy property expenditures (see below), up to an aggregate amount of **\$1,500** in credits. The expenses must be made on or in connection with a dwelling unit *located in the U.S.*, owned and used by the taxpayer as his *principal residence*, and *originally placed in service by the taxpayer*.

 **Observation:** The aggregate \$1,500 credit limit means that up to \$5,000 of a taxpayer's qualify expenditures can qualify for the 30% credit ($\$5,000 \times .30 = \$1,500$).

 **Observation:** Taxpayers who had exhausted their \$500 lifetime limitation that applied in 2006 and 2007 under the pre-ARRA credit can now claim an additional \$1,500 of aggregate credits in 2009 and 2010. (No credit was available for 2008.)

Qualified energy efficiency improvements are energy efficient building envelope components that meet criteria established by the 2000 International Energy Conservation Code (that meet Energy Star program requirements in the case of certain metal and asphalt roofs). These building envelope components consist of insulation materials or systems specifically and primarily designed to reduce heat loss/gain that meet the 2009 International Energy Conservation Code; exterior windows (including skylights); exterior doors; and certain metal or asphalt roofs installed on a dwelling unit with pigmented coatings or cooling granules to reduce heat gain. The components must be expected to last for at least five years.

Residential energy property expenses are expenses for qualified energy property (including labor costs for onsite preparation, assembly, or original installation) that meet specific standards set forth in Code Sec 25C(d)(2)(B) and Code Sec 25C(d)(2)(C). Such property includes:

... energy-efficient building property (electric heat pump water heater, electric heat pump; central air conditioner; natural gas, propane or oil water heater; or a stove burning biomass fuel to heat or provide hot water to a taxpayer's residence in the U.S.) that meets specific energy efficiency standards;

... a qualified natural gas, propane, or oil furnace;

... a qualified natural gas, propane, or oil hot water boiler; or

... an advanced main air circulating fan.


If a credit is allowed for an expense for a property, the increase in the basis of that property that would otherwise result is reduced by the credit allowed.

*Changes to the **Residential Energy Efficient Property Credit**. EESA made a number of changes to the Code Sec 25D credit. Among them, EESA:*

- extended the credit for eight years, for property placed in service before 2017,

- removed the \$2,000 limitation on the credit allowed for qualified solar energy property expenditures for tax years beginning after 2008, and

- added two new components to the 30% credit for tax years beginning after 2007—qualified small wind energy property expenditures and geothermal heat pump property expenditures.

 **Observation:** Geothermal heat pumps had qualified for the Code Sec 25C nonbusiness energy property credit. This property was eliminated from that credit and added to the Code Sec 25D residential energy efficient property credit because at the time such property had been limited to \$300 as an item of energy-efficient building property under Code Sec 25C.

The bill provided that the credit could be claimed against *both* regular tax and alternative minimum tax.

ARRA made additional changes to the Code Sec 25D credit. Among them,

- it removed the \$2,000 credit caps for solar hot water and geothermal property, and the \$4,000/ \$500 per half kilowatt of capacity limit for small wind property for tax years beginning after 2008, and

- eliminated the limitation on subsidized energy financing in determining amounts that could qualify for the credit.

The present day residential energy efficient property credit. For property placed in service before 2017, an individual is allowed an annual credit (on Form 5695) for the purchase of residential energy efficient property equal to the sum of:


- (1) 30% of the amount paid for qualified solar energy property (i.e., property that uses solar power to generate electricity in a home);

- (2) 30% of the amount paid for qualified solar water heating property;

- (3) 30% of the amount paid for qualified fuel cell property, up to a maximum credit of \$500 for each 0.5 kilowatt of capacity;

- (4) 30% of the amount paid for qualified small wind energy property; and

- (5) 30% of the amount paid for qualified geothermal heat pump property.

 **Observation:** Thus, except for qualified fuel cell property, no dollar limit applies for the residential energy efficient property credit, and a taxpayer can claim 30% of qualifying expenditures made during the tax year for qualified solar water heating, geothermal heat pump, small wind energy, and solar electric property. For qualified fuel cell property expenditures, the credit for any tax year can't exceed \$500 for each 0.5 kilowatt of capacity of the qualified fuel cell property to which the expenditure relates.

Qualified solar electric, solar water heating, small wind energy, and geothermal heat pump property must be used in a dwelling unit located in the U.S. and used as a residence by the taxpayer. Qualified fuel cell property, must be used in a dwelling unit located in the U.S. and used as the taxpayer's principal residence. The credit is allowed for expenditures for labor costs properly allocable to the onsite preparation, assembly, or original installation of the residential energy efficient property and for piping or wiring to interconnect the property to the dwelling unit.

Highlighted Business Tax Law Changes for 2009:

Expensing Deduction. For tax years beginning in 2009, the expensing limit is \$250,000 and the investment ceiling limit is \$800,000. However, unless Congress modifies the rules once again, the expensing limit for 2010 will be halved to \$125,000 and the investment ceiling will be reduced to \$500,000 (with adjustments for inflation). The estimate based on CPI figures is that the inflation-adjusted amount that may be expensed under Code Sec 179 for **2010** will be **\$134,000**, and that the expensing limit will be reduced when more than **\$530,000** of expensing-eligible property is placed in service. This means that many small and medium sized businesses that make timely purchases will be able to currently deduct most if not all their outlays for machinery and equipment. What's more, the expensing deduction is not prorated for the time that the asset is in service during the year. This opens up significant year-end planning opportunities.

Bonus First-Year Depreciation Deduction. Most new machinery and equipment (as well as software) *bought and placed in service in 2009* qualifies for a 50% bonus first year depreciation deduction. Unless Congress extends this tax break, property bought and placed in service *next year generally won't qualify* (exceptions apply for specialized types of properties). Thus, enterprises planning to purchase new depreciable property this year or the next should try to accelerate their buying plans, if doing so makes sound business sense.

Deduction for Qualified Production Activities Income.

Taxpayers can claim a deduction, subject to limits, for a specified percentage (6% for tax years beginning in 2007-2009, 9% in later years) of the lesser of (1) the taxpayer's "qualified production activities income" for the tax year (i.e., net income from U.S. manufacturing, production or extraction activities, U.S. film production, U.S. construction activities, and U.S. engineering and architectural services), or (2) the taxpayer's taxable income for that tax year before taking this deduction into account. This deduction generally has the effect of a reduction in the taxpayer's marginal rate and, thus, should be taken into account when making decisions regarding income shifting strategies.

Estimated Tax Relief for Owners of Small Businesses.

If an individual's Adjusted Gross Income for 2008 was less than \$500,000 and more than half of the gross income was from a business with fewer than 500 workers, the estimated income taxes for 2009 estimated tax payments can be based on the lesser of 90 percent of tax liability for 2008 or 2009. The usual estimated tax benchmarks of 100 percent or 110 percent of tax liability do not apply.

Net Operating Losses and Debt Cancellation Income.

A business with a loss this year may be able to use that loss to generate cash in the form of a quick net operating loss carryback refund. This type of refund may be of particular value to a financially troubled business that needs a fast cash transfusion to keep going. There also are a number of different kinds of debt cancellation or debt reduction transactions that may generate taxable income in 2009 if not deferred until next year.