

Tax Changes for Individuals in the Recovery Package

On Feb. 17, President Obama signed into law a \$787 billion stimulus package, called the American Recovery and Reinvestment Act of 2009 (P.L. 111-5). This package included nearly \$300 billion in tax relief and more than 300 changes to the Internal Revenue Code. Here are some key tax credits and other provisions in the new law.

Making Work Pay Credit

A year ago, the Economic Stimulus Act of 2008 (P.L. 110-185) provided rebate checks for millions of Americans. Checks were sent to the most eligible individuals during the spring and summer. Now the American Recovery and Reinvestment Act of 2009 (ARRA) provides for payments made primarily through adjustments in employees' take-home pay. The new Making Work Pay credit is 6.2% of earned income up to a maximum of \$400 (\$800 for couples filing jointly). Although the credit is based on the Social Security tax rate used for FICA, receipt of the credit does not impact Social Security benefits. The credit applies for both 2009 and 2010.

The credit has an income limitation, so some employees who receive paycheck adjustments will be required to pay the money back when they file their 2009 income tax returns. The full credit applies only for those with modified adjusted gross income (MAGI) no more than \$75,000 for singles, or \$150,000 for married persons filing jointly. A partial credit applies for singles with MAGI between \$75,000 and \$95,000, and for joint filers with MAGI between \$150,000 and \$190,000. No credit can be claimed when MAGI exceeds \$95,000 for singles, or \$190,000 for joint filers.

Employees do not have to do anything to receive the payments; they are automatic. Some employees, however, might wish to adjust their withholding allowances by filing a new Form W-4 with their employers so they will not have an underpayment when they file their 2009 returns. For example, if someone works two jobs, each employer will include the stimulus payment in the paycheck. When the employee files the 2009 return, only one payment will be allowed (assuming income is below the MAGI limit).

Self-employed individuals are also entitled to the Making Work Pay credit. Because they do not receive wages, they claim their credit by adjusting estimated taxes for 2009. Alternatively, they will claim it when they file their 2009 income tax return.

■ **One-time payment for certain individuals:** Recipients of Social Security benefits, Railroad Retirement benefits, veterans' benefits and SSI as well as federal and state pensioners not eligible for Social Security receive a one-time payment of \$250 (regardless of their MAGI). Receipt of this one-time payment does not affect benefits under these government programs. The payments are made to recipients by the agency paying their benefits (e.g., Social



"The new Making Work Pay credit is 6.2% of earned income up to a maximum of \$400 (\$800 for couples filing jointly)."

**TAX
STRATEGY
ADVISOR**

Sidney Kess, CPA, J.D., LL.M.

Security Administration).

Anyone eligible for both the Making Work Pay credit and a one-time payment will only receive one payment. For example, say a person age 68 is working and collecting Social Security benefits. The person will receive the Making Work Pay credit, but not the \$250 one-time payment.

First-time Homebuyer Credit

The Housing Assistance Tax Act of 2008 (P.L. 110-289) created a tax credit for certain homebuyers who purchased a principal residence after April 8, 2008. ARRA expands on this credit.

For homes purchased in the first 11 months of 2009, the credit is 10% of the purchase price, up to a top credit of \$8,000 (\$4,000 for married persons filing separately). The credit for homes purchased during the eligibility period in 2008 is limited to \$7,500 (\$3,750 for married persons filing separately).

To qualify, the homeowner (and spouse) must not have owned a principal residence within three years of the date of purchase. Also, MAGI cannot exceed set limits. The credit phases out for those with MAGI between \$75,000 and \$95,000 if single, or \$150,000 and \$170,000 if married filing jointly. (The same limits apply in 2008 and 2009.)

The credit is subject to recapture. For homes purchased in 2008, the credit is repaid in 15 equal installments starting in the second year after the credit is claimed (e.g., a \$7,500 credit claimed for a home bought in 2008 is recaptured at \$500 per year starting in 2010). There are some exceptions to this recapture rule. For homes purchased in 2009, the credit is recaptured in full if the home is sold or no longer used as a principal residence within 36 months of the purchase.

Filing option: Eligible homebuyers in 2009 can opt to claim their credit on the 2008 income tax return. The 2009 credit limit and repayment rule applies even though the credit is reported on

Continued on page 20

Energy-Efficient Home Improvement Credit is 30% with \$1,500 Maximum

Continued from page 6

the 2008 return. Use new IRS Form 5405, First-Time Homebuyer Credit, for this purpose.

American Opportunity Tax Credit

ARRA replaces the Hope credit with a new American opportunity credit for 2009 and 2010 (Code Sec. 25A(i)(1)). The new credit applies for the first four years of college. (The Hope credit had been limited to the first two years of college.)

The credit amount is 100% of the first \$2,000 of tuition and other eligible expenses, plus 25% of the next \$2,000 of such costs, for a top credit of \$2,500. (The Hope credit had been limited in 2008 to \$1,800.)

The credit is subject to an income cap. The credit phases out for singles with MAGI between \$80,000 and \$90,000, and for joint filers with MAGI between \$160,000 and \$180,000. (These limits are considerably higher than the MAGI limits that applied for the Hope credit.)

ARRA makes 40% of the credit refundable; it can be paid to eligible taxpayers in excess of their tax liability.

Residential Energy Credits

Homeowners can use two tax credits to offset the cost of making certain energy improvements to their homes. The credits apply only to a principal residence; no income caps apply.

■ **Energy-efficient home improvements** (Code Sec. 25C): The credit is 30% of the cost of eligible improvements to the home. The credit applies for improvements made in 2009 and 2010, with a maximum credit limit of \$1,500 over these two years. Eligible improvements include insulation, storm windows and/or doors, fans, furnaces, metal roofs and water heaters that meet certain energy standards. Information about eligible improvements can be found at Energy-Star (www.energystar.gov).

■ **Alternative energy improvements** (Code Sec. 25D): The credit is 30% of the cost of eligible property; there is no dollar cap. The credit applies for the installation of solar panels, solar water heaters, geothermal heat pumps and fuel cells. The credit applies even if the improvements are paid for with subsidized energy financing.

Note: State tax incentives, such as sales tax waivers and income tax breaks, may also apply.

Other Tax Provisions

Other important changes in ARRA include the following:

■ **Alternative minimum tax (AMT)** (Code Sec. 55(d)(1)(A)): ARRA provides a one-year "patch" for AMT to keep more than 25 million

taxpayers from owing this tax in 2009. The patch is accomplished by allowing *all* nonrefundable personal tax credits to offset both regular tax and AMT liability, and by increasing the AMT exemption amounts. The AMT exemption amounts for 2009 are \$70,950 for joint filers (up from \$69,950 in 2008) and \$46,700 for singles (up from \$46,200 in 2008).

■ **COBRA coverage:** Those whose employment is involuntarily terminated after Sept. 8, 2008, and before Jan. 1, 2010, and who opt for COBRA coverage under the employer's group health plan need only pay 35% of the premiums for nine months; the federal government will pay 65% of the premiums for this period.

Those terminated before Feb. 18, 2009, and who initially failed to opt for COBRA have until April 18, 2009, to opt in. However, subsidy is tax-free only if MAGI is below \$125,000 for singles and \$250,000 for joint filers.

■ **Unemployment benefits** (Code Sec. 85(c)): Although such income usually is includible in gross income, the first \$2,400 of government-paid unemployment benefits in 2009 is excludable from gross income.

■ **New car buyer incentive** (Code Sec. 164(a)(6)): For new vehicles (passenger vehicles, light trucks, and motorcycles weighing 8,500 or less) purchased after Feb. 17, 2009, and before Jan. 1, 2010, the buyer can deduct state and local sales taxes and excise taxes on the purchase price up to \$49,500. The deduction can be claimed as an adjustment to gross income. (Itemizing is not necessary to use this tax break).

However, the deduction phases out for those with MAGI between \$125,000 and \$135,000 if single, or \$250,000 and \$260,000 if married filing jointly.

■ **529 plans** (Code Sec. 529(e)(3)(A)(iii)): Tax-free distributions can be taken from these college savings plans in 2009 and 2010 to pay for computer technology, including the purchase of computers and Internet access. The computer need not be used exclusively for education, but its purchase must be required by the school. However, the purchase of software for gaming, sports or hobbies qualifies only if it is "predominantly educational in nature."

■ **Transportation fringe benefit parity** (Code Sec. 132(f)(2)): For 2009 and 2010, the exclusion amount that applies for employer-paid free parking (\$230 per month in 2009) applies to monthly transit passes and van pooling (each of which had been scheduled to be limited to \$120 per month). ☺

Sidney Kess, CPA, J.D., LL.M., has authored hundreds of books on tax-related topics. He probably is best known for lecturing to more than 700,000 practitioners on tax and estate planning.