

## Haws, Theobald & Auman PC

The American Recovery and Reinvestment Act of 2009 (ARRA) includes several brand new tax incentives, as well as changes to existing tax provisions. Some of the changes created as a result of this and other tax acts are summarized below.

***Making Work Pay Credit*** - The ARRA provides eligible individuals with a refundable income tax credit of 6.2% of their earned income up to \$400 (\$800 for married filing jointly) for 2009 and 2010 called the Making Work Pay Credit. The credit will be implemented through revised federal income tax withholding schedules, so most taxpayers with withholdings will see a reduction in their tax withheld, beginning April 1, 2009 at the latest. Taxpayers who have earned income, but are not subject to federal income tax withholding, will generally receive the credit on their 2009 tax return; estimated tax payments may be reduced to receive the credit in advance. This credit phases out for taxpayers with modified adjusted gross income over \$75,000 (\$150,000 for married filing jointly).

**Federal Tax Changes - We are very concerned that certain taxpayers that fall into any of the following groups may not have enough Federal withholding for 2009 and thus incur penalties or owe tax this year.**

**Multiples job or pension holders**

**Families in which both spouses work**

**Workers who can be claimed as dependant by other taxpayers**

**California Tax Changes- One factor that may be easily overlooked is the changes the legislature made to the state's personal income taxes earlier this year. A surcharge of .25 percent on personal income went into effect, dependent care credit was reduced, and employers will have to increase withholding.**

***Please review your withholding to ensure you are having enough withheld.***

***First-time Homebuyer Credit*** - The First-Time Homebuyer credit has been increased to equal 10% of the purchase price of the principal residence, up to \$8,000 (\$4,000 for married filing separately) for homes purchased after December 31, 2008 and before December 1, 2009. Principal residences purchased after December 31, 2008, are not subject to any credit repayment if the home remains the principal residence of the taxpayer for 36 months.

***New sales tax deduction for vehicle purchases*** - There is a new deduction for state and local sales taxes paid on the purchase of a new car, light truck, motor home or motorcycle after February 16, 2009 and before January 1, 2010. This deduction is generally available whether or not you itemize your deductions. The deduction begins to phase out at modified adjusted gross income over \$125,000 (\$250,000 married filing jointly).

***Earned Income Credit Changes*** - For 2009 and 2010, the earned income credit is increased to 45% for families with three or more qualifying children. This increased percentage may result in up to an additional \$628.50 earned income credit for families with three or more qualifying children. The earned income credit for two children, one child, or no children remains at 40%, 34%, and 7.65%, respectively. The phase-out amounts for married couples filing jointly used to determine the allowable earned income credit increases from \$3,000 to \$5,000 for 2009 and 2010. This increase may result in a larger earned income credit for some jointly filed returns.

***Refundable Child Tax Credit*** - The ARRA lowers the earned income threshold used to determine the refundable portion of the child tax credit from \$8,500 (for 2008 returns) to \$3,000 (for 2009 and 2010 returns).

***Estimated Tax Payments for Small Businesses*** - ARRA reduces the required annual payment of estimated taxes for certain qualified individuals with small businesses to the lesser of (1) 90% of the tax shown on the return for 2009, or (2) 90% of the tax shown on the return for 2008. A qualified individual with a small business earns less than \$500,000 (\$250,000 if married filing separately) and at least half of the gross income on their 2008 return is from a small trade or business which employs no more than 500 people.

***AMT relief*** - The exemption amounts for alternative minimum tax (AMT) calculations have been increased for 2009 to \$46,700, \$70,950 if married filing jointly or qualifying widow(er), or \$35,475 if married filing separately. Also extended for 2009 is the tax provision that allowed most nonrefundable personal credits to be claimed up to the sum of regular and AMT.

***2008 net operating losses (NOLs) for small businesses eligible for special carryback periods*** - ARRA allows NOLs generated in 2008 to be carried back 3, 4, or 5 years for qualifying small businesses (gross receipts of \$15 million or less). Taxpayers must elect the special carryback treatment on the original tax return filed by the due date of the return, including extensions.

***American Opportunity Tax (Hope Education) Credit*** - For 2009 and 2010, taxpayers can claim a tax credit up to \$2,500 of the cost of tuition and related expenses for the first four years of post-secondary education in a degree or certificate program. The credit is based on 100% of the first \$2,000 in qualified expenses and 25% of the next \$2,000. The definition of qualifying expenses is expanded to include textbooks and the credit is now available for up to four years instead of only the first two years of college. The phase-out range of this credit was expanded so more taxpayers are eligible. The phase-out range starts at modified adjusted gross income of \$80,000 (\$160,000 for married filing jointly). The Hope Credit was only available as a non-refundable in the past, but now families that don't owe taxes may receive a refundable credit of up to a maximum of \$1,000 per student.

***Computers allowed as education expense*** - Beginning in 2009 and 2010 computers and related technology qualifies as a qualified education expenses in 529 education plans.

***Tax break for the unemployed*** - Under ARRA, an individual does not have to pay tax on up to \$2,400 in unemployment benefits received in 2009.

#### **Tax Provisions That Are Still in Effect for 2009:**

***Above the line Educator expenses and Tuition and fees deduction*** - The EESA extends the above-the-line deductions for educator and higher education expenses (i.e. tuition and fees deduction) through 2009.

***Option to claim state sales and use tax instead of state and local income tax on Schedule A*** - EESA also extends the law created under the American Jobs Creation Act of 2004 (AMJOBS2004) allowing a deduction of state and local general sales tax through 2009.

***Tax-free distributions from IRA's for charitable purposes*** - The Pension Protection Act of 2006 included a special rule for IRA distributions to charities in tax years 2006 and 2007. The EESA extends this special rule to tax years 2008 and 2009. The rule allowed qualified charitable distributions to be excluded from gross income by taxpayers age 70 ½ or older. Distributions were allowed from either a

traditional or Roth IRA. The tax-free IRA distributions are not eligible to be taken as a charitable deduction on Schedule A.

***Kiddie tax Increased Age*** - The Small Business and Work Opportunity Tax Act of 2007 expanded the reach of the Kiddie Tax to apply to children under age 19 and children over 18 but under age 24 who are full-time students. Children subject to the kiddie tax pay tax at the parents' highest marginal tax rate on unearned income over \$1,900 (\$1,800 in 2008).

***Mortgage insurance deduction*** - The available itemized deduction for the cost of mortgage insurance paid in connection with the purchase of a qualified residence (more commonly referred to as PMI) has been extended through December 31, 2010. Phase-out limits exist for taxpayers with AGI over \$100,000.

***Mortgage Debt Forgiveness*** - The Emergency Economic Stabilization Act of 2008 extends legislation created by the Mortgage Relief Act of 2007 which allows debt forgiven on a mortgage secured by a qualified principal residence to be excluded from gross income. Only mortgage debt used to acquire or improve the principal residence qualifies for the exclusion. No tax relief is allowed for home equity loans, business properties, rental properties or second mortgages not used to acquire, build, or substantially improve a principal residence. The amount that may be excluded is limited to \$2 million for married individuals filing jointly (\$1 million for married individuals filing separately) and applies to debt forgiven in 2008, 2009, 2010, 2011, or 2012.

***Gifts to Charity*** - The Pension Protection Act of 2006 provided new rules for deducting charitable contributions. Beginning in 2007, taxpayers are now required to obtain a written acknowledgment or bank record for donations of cash, check, or other monetary value, regardless of the amount. Supporting documentation from the donee organization should include the name of the charity, the date of the contribution, and the amount of the contribution. As required by pre-2007 law, contributions of \$250 or more still require a statement from the charitable organization (i.e. a bank record is not enough to substantiate such a deduction). The Act also applied stricter rules for post-August 17, 2006, contributions of clothing and household items.

**Sincerely,**

**Haws, Theobald & Auman PC**