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Dear Clients and Friends:

2009 Economic Recovery Act—Individual Income Tax Provisions

The recently enacted *American Recovery and Reinvestment Act of 2009* (the Recovery Act) contains a wide-ranging tax package that includes tax relief for low and moderate-income wage earners, individuals and families with college expenses, and certain home and car purchasers.

But before we get into the provisions of the Recovery Act, here are some things that did **not** change (yet):

- The federal “qualified” dividend rate is still 15% in 2009.
- The federal long-term capital gain rate is still 15% in 2009 (for the most common long-term capital gains).
- The federal income tax brackets were indexed for inflation again for 2009 and the maximum ordinary income tax rate is still 35% for 2009.
- The annual gift tax exclusion indexed upward from \$12,000 to \$13,000 per donee for 2009 (twice those amounts with spousal gift splitting).
- The lifetime gift tax exclusion remained at \$1,000,000 for 2009.
- The estate tax exclusion indexed upward to \$3,500,000 per person for 2009 and the maximum rate remained at 45% for 2009.

For more on these and other items, see our “Taxes at a Glance” at the JVTR website (www.jvtr.com).

Following is an overview of the more widely applicable Recovery Act changes affecting individuals and families. For purposes of some of the paragraphs below, a tax “credit” is a dollar for dollar reduction of tax. A “refundable” tax credit is one that results in an actual refund of the unused portion of the credit when the tax liability is less than the amount of the credit.

“Making Work Pay” credit. The Recovery Act provides a **refundable** 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 over the adjusted gross income (AGI) range from \$75,000 to \$95,000 for single earners who earn at least \$6,450 per year and from \$150,000 to \$190,000 for married earners who file jointly and who both earn at least \$6,450 per year. The credit can be claimed as a reduction in the amount of income tax that is withheld from paychecks, or through a credit on the individual income tax return.

Economic recovery payment. The Recovery Act provides for a one-time 2009 payment of \$250 to certain adults who are eligible for Social Security benefits or Railroad Retirement benefits, veterans receiving disability compensation and pension benefits from the U.S. Department of Veterans' Affairs, and SSI recipients receiving benefits from the Social Security Administration. The one-time payment is a reduction to the otherwise allowable "Making Work Pay" credit described above.

Credit for certain federal and state pensioners. The Recovery Act provides a one-time **refundable** tax credit of \$250 in 2009 to certain government retirees who are not eligible for Social Security benefits. The one-time credit is also a reduction to the otherwise allowable "Making Work Pay" credit described above.

Unemployment compensation exclusion. The Recovery Act excludes from gross income a maximum of \$2,400 of unemployment benefits received by a recipient in 2009.

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

Expanded "Additional" child tax credit. The Recovery Act increases the eligibility for the refundable portion of the "Additional" child tax credit (ACTC) in 2009 and 2010 by lowering the income threshold to \$3,000 (from \$8,500 in 2008). This is the **refundable** portion of the Child Tax Credit (CTC), and is allowed for certain taxpayers who cannot claim the full CTC because their tax liability is not high enough. The child tax credit is phased out for taxpayers with income over specified levels.

Expanded and revised higher education tax credit—The American Opportunity Tax Credit. The Recovery Act creates a \$2,500 higher education tax credit for each child for 2009 and 2010 for the first four (not just two) 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. The credit is phased out over the AGI range from \$80,000 to \$90,000 for single filers and from \$160,000 to \$180,000 for married taxpayers filing jointly. A portion of the resulting credit—40% of it, is **refundable**. This new credit temporarily replaces the Hope credit.

Computers as an education expense. The Recovery Act permits purchases of computers and computer technology to qualify as qualified education expenses in IRC Section 529 education plans for expenses paid or incurred in 2009 or 2010.

Expanded credit for first-time home buyers. In 2008, 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 a maximum of \$7,500 (\$3,750 on a separate return) by “first-time” home buyers (defined as no ownership in a principal residence in the three year period prior to purchase). The provision applied to homes purchased after April 8, 2008 and before July 1, 2009. Taxpayers receiving this tax credit were (and still are if they bought prior to January 1, 2009) 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). That credit was phased out for taxpayers with an AGI range from \$75,000 to \$95,000 for single filers and from \$150,000 to \$170,000 for joint filers.

The Recovery Act increases the maximum amount of the credit from \$7,500 to \$8,000 and enhances the credit by eliminating the repayment obligation for taxpayers that purchase homes on or after January 1, 2009 and before December 1, 2009. But to retain the full 2009 credit, the taxpayer(s) must hold the home for at least three years. Taxpayers may elect to claim the credit for a pre December 1, 2009 purchase on their 2008 tax returns.

Tax break for certain new car purchasers. The Recovery Act allows taxpayers to deduct state and local sales taxes paid on up to \$49,500 of the cost of certain new automobiles, including light trucks, SUVs, motorcycles, and motor homes that are purchased on or after February 17, 2009 and before January 1, 2010. The tax deduction is phased out over a modified AGI range from \$125,000 to \$135,000 for single filers and from \$250,000 to \$260,000 for joint filers. The deduction is allowed to both those who itemize their deductions as well as to non-itemizers. If a taxpayer takes the sales tax deduction “above the AGI line,” and the taxpayer itemizes, and in so doing the taxpayer elects to take an itemized deduction for state and local sales taxes in lieu of state and local income taxes, that taxpayer cannot take an itemized deduction for the same sales tax deduction that was claimed “above the AGI line.”

Alternative minimum tax (AMT) “patch”. To reduce the number of taxpayers subject to the AMT, the Recovery Act increases the AMT exemption amounts for 2009 to \$46,700 for single filers and \$70,950 for joint filers. The Recovery Act also allows various personal credits to offset the AMT. The Recovery Act also treats certain private activity bonds issued in 2009 and 2010 as not being an AMT tax “preference” item in 2009 and 2010.

We hope this information is helpful. If you would like more details about this or any other aspect of the new law, please do not hesitate to contact us.

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