

The American Recovery and Reinvestment Act of 2009

Congress has approved and the President has signed new economic recovery legislation, the American Recovery and Reinvestment Act of 2009. The IRS is implementing tax-related provisions of this new program as quickly as possible.

Here are some key highlights:

Money Back for New Vehicle Purchases. Taxpayers who buy certain new vehicles in 2009 can deduct the state and local sales taxes they paid. The American Recovery and Reinvestment Act of 2009 provides a deduction for state and local sales and excise taxes paid on the purchase of new cars, light trucks, motor homes and motorcycles through 2009. The deduction is available regardless of whether a taxpayer itemizes deductions on Schedule A. Purchases before Feb. 17, 2009, are not eligible for this special deduction.

The deduction is limited to the tax on up to \$49,500 of the purchase price of an eligible motor vehicle. The deduction is phased out for joint filers with modified adjusted gross income between \$250,000 and \$260,000 and other taxpayers with modified AGI between \$125,000 and \$135,000.

Increased Transportation Subsidy. Employer provided benefits are up in 2009. Under the American Recovery and Reinvestment Act (ARRA), the monthly tax exclusion for employer-provided commuter highway vehicle transportation and transit pass benefits increased to \$230, effective from March through December 2009.

Employees may exclude from income \$230 per month in transit benefits and \$230 per month in parking benefits — up to a maximum of \$460 per month. Employees may receive benefits for commuter transportation and transit passes and benefits for parking during the same month; they are not mutually exclusive.

Previously, there were two separate monthly exclusion amounts, one for commuter highway transportation, such as commuter vans, and transit passes and a different one for qualified parking. The exclusion amount for qualified parking was set at a higher rate. The new law makes all the exclusion amounts equal and sets them at the higher rate for qualified parking. The law provides the equal benefits through Dec. 31, 2010.

These qualified transportation fringe benefits are excluded from an employee's gross income for income tax purposes and from an employee's wages for payroll tax purposes.

Up to \$2,400 in Unemployment Benefits Tax Free in 2009. Under the American Recovery and Reinvestment Act (ARRA), the first \$2,400 of unemployment benefits an individual receives in 2009 are tax free. This provision applies only to benefits received in 2009: Normally, unemployment benefits are taxable.

Individuals who receive unemployment benefits this year should check their withholding to ensure they are not having unnecessary tax withheld.

Net Operating Loss Carryback. Small businesses can offset losses by getting refunds on taxes paid up to five years ago. Information on the carryback, an expanded section 179 deduction and other business-related provisions is now available. Small businesses with deductions exceeding their income in 2008 can use a new net operating loss tax provision in the American Recovery and Reinvestment Act (ARRA) to get a refund of taxes paid over the past five years instead of the usual two.

To accommodate the change in tax law, the IRS has updated Publication 536, as well as the instructions for Form 1045 and Form 1139, which small businesses will use to take advantage of the carryback provision.

Section 179 Deduction

A qualifying taxpayer can choose to treat the cost of certain property as an expense and deduct it in the year the property is placed in service instead of depreciating it over several years. This property is frequently referred to as section 179 property.

Under ARRA, qualifying businesses can continue to expense up to \$250,000 of section 179 property for tax years beginning in 2009. Without ARRA, the 2009 expensing limit for section 179 property would have been \$133,000. The \$250,000 amount provided under the new law is reduced if the cost of all section 179 property placed in service by the taxpayer during the tax year exceeds \$800,000.

The new law does not alter the section 179 limitation imposed on sport utility vehicles, which have an expense limit of \$25,000.

More Help for Small Business

The Recovery Act also includes the following business-related provisions:

Reduction of Estimated Tax Payments: Normally, small businesses have to pay 110 percent of their previous year's taxes in estimated taxes. The Recovery Act permits small businesses to reduce their estimated payments to 90 percent of the previous year's taxes.

Extension of Bonus Depreciation Deductions Through 2009: Bonus depreciation is extended through 2009, allowing businesses to take a larger tax deduction within the first year of a property's purchase.

Capital Gains Tax Break for Investment in Small Business: Investors in small business who hold their investments for five years can exclude from taxation 75 percent of their capital gains.

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COBRA: Health Insurance Continuation Subsidy. The IRS has extensive guidance for employers, including an updated Form 941, as well as information for qualifying individuals. Workers who have lost their jobs may qualify for a 65 percent subsidy for COBRA continuation premiums for themselves and their families for up to nine months.

Eligible workers will have to pay 35 percent of the premium to their former employers.

To qualify, a worker must have been involuntarily separated between Sept. 1, 2008, and Dec. 31, 2009. Workers who lost their jobs between Sept. 1, 2008, and enactment, but failed to initially elect COBRA because it was unaffordable, get an additional 60 days to elect COBRA and receive the subsidy.

This subsidy phases out for individuals whose modified adjusted gross income exceeds \$125,000, or \$250,000 for those filing joint returns. Taxpayers with modified adjusted gross income exceeding \$145,000, or \$290,000 for those filing joint returns, do not qualify for the subsidy.

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First-Time Homebuyer Credit Expands. Homebuyers who purchase in 2009 can get a credit of up to \$8,000 with no payback requirement. The American Recovery and Reinvestment Act of 2009 expands the first-time homebuyer credit to include purchases made before Dec. 1, 2009.

The IRS announced Feb. 25 that for first-time homebuyers who purchase in 2009, the maximum credit is \$8,000 and can be claimed on a buyer's 2008 federal tax return. If the home purchase closes after April 15, a taxpayer can still claim the credit on a 2008 tax return by requesting an extension of time to file or filing an amended return.

The credit is claimed using Form 5405.

For first-time homebuyers who bought in 2008, the maximum credit is \$7,500 and must be paid back over a period of 15 years.

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Enhanced Credits for Tax Years 2009, 2010. Details available on the earned income tax credit, additional child tax credit and American Opportunity Credit, a new higher education benefit.

EARNED INCOME TAX CREDIT - The American Recovery and Reinvestment Act (ARRA) provides a temporary increase in the earned income tax credit (EITC) for taxpayers with three or more qualifying children. The maximum EITC for this new category is \$5,657. ARRA also increases the beginning point of the phaseout range for the credit for all married couples filing a joint return, regardless of the number of children. These changes apply to 2009 and 2010 tax returns.

The earned income tax credit is a refundable credit intended to help people who work but earn modest incomes. The credit begins to phase out at \$21,420 for married taxpayers filing a joint return with children and completely phases out at \$40,463 for one child, \$45,295 for two children and \$48,279 for three or more children. For married taxpayers filing a joint return with no children, the credit begins to phase out at \$12,470 and completely phases out at \$18,440.

ADDITIONAL CHILD TAX CREDIT - Under the American Recovery and Reinvestment Act (ARRA), more families will be eligible for the additional child tax credit because of a change to the way the credit is figured.

Taxpayers who cannot take full advantage of the child tax credit because the credit is more than the taxes they owe may receive a payment for some or all of the credit not used to offset their taxes. It is a refundable credit, which means taxpayers may receive refunds even when they do not owe any tax.

ARRA reduces the minimum earned income amount used to calculate the additional child tax credit to \$3,000. Before ARRA, the minimum earned income amount was set to rise to \$12,550. Reducing the amount to \$3,000 permits more taxpayers to use the additional child tax credit and increases the amount of the payments they may receive.

This change applies to tax years beginning in 2009 and 2010.

AMERICAN OPPORTUNITY CREDIT - Under the American Recovery and Reinvestment Act (ARRA), more parents and students will qualify over the next two years for a tax credit, the American Opportunity Credit, to pay for college expenses.

The American Opportunity Credit is not available on the 2008 returns taxpayers are filing during 2009. The new credit modifies the existing Hope Credit for tax years 2009 and 2010, making the Hope Credit available to a broader range of taxpayers, including many with higher incomes and those who owe no tax. It also adds required course materials to the list of qualifying expenses and allows the credit to be claimed for four post-secondary education years instead of two. Many of those eligible will qualify for the maximum annual credit of \$2,500 per student.

The full credit is available to individuals whose modified adjusted gross income is \$80,000 or less, or \$160,000 or less for married couples filing a joint return. The credit is phased out for taxpayers with incomes above these levels. These income limits are higher than under the existing Hope and Lifetime Learning Credits.

Payroll Checks Increase This Spring. The Making Work Pay Tax Credit will mean \$400 to \$800 for many Americans. The IRS has issued new withholding tables for employers. Attention Employers: The IRS has issued updated withholding tables to help you implement the withholding adjustments required by the new economic stimulus law. News release 2009-13 includes information about these tables.

For 2009 and 2010, the Making Work Pay provision of the American Recovery and Reinvestment Act will provide a refundable tax credit of up to \$400 for working individuals and \$800 for married taxpayers filing joint returns.

This tax credit will be calculated at a rate of 6.2 percent of earned income and will phase out for taxpayers with adjusted gross income in excess of \$75,000, or \$150,000 for married couples filing jointly.

For people who receive a paycheck and are subject to withholding, the credit will typically be handled by their employers through automated withholding changes in early spring. These changes may result in an increase in take-home pay. The amount of the credit must be reported on the employee's 2009 income tax return filed in 2010. Taxpayers who do not have taxes withheld by an employer during the year can also claim the credit on their 2009 tax return.

It is not necessary to submit a Form W-4 to get the automatic withholding change. However, an employee with multiple jobs or married couples whose combined incomes place them in a higher tax bracket may elect to submit a revised W-4 to ensure enough withholding is held to cover the tax for his or her combined income. Publication 919 provides additional guidance for tax withholding including a special Making Work Pay worksheet.

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\$250 for Social Security Recipients, Veterans and Railroad Retirees. The Economic Recovery Payment will be paid by the Social Security Administration, Department of Veterans Affairs and the Railroad Retirement Board.

A one-time payment of \$250 will be made in 2009 to:

Retirees, disabled individuals and Supplemental Security Income (SSI) recipients receiving benefits from the Social Security Administration.

Disabled veterans receiving benefits from the U.S. Department of Veterans Affairs.

Railroad Retirement beneficiaries.

The IRS will not make this payment — unlike last year's economic stimulus program. Individuals who may qualify for this year's economic recovery payment should contact their respective agency for more information.

The Social Security Administration Web site has a special section on the economic recovery payment. The economic recovery payment will be a reduction to any Making Work Pay credit for which the recipient qualifies. The Making Work Pay credit will be claimed on the recipient's 2009 tax return filed in 2010.

Following are a few general questions and answers regarding the new recovery package:

Could the new law affect 2008 tax returns? Generally, no. The new law does not have any major impact for the vast majority of individuals preparing their 2008 tax returns due April 15. Instead, these changes will largely impact 2009 tax returns filed next year, in 2010. Taxpayers should continue to prepare their 2008 tax returns as they normally would.

There are a few limited areas in the law that could impact 2008 tax returns. For some small businesses, changes in the net operating loss provisions could affect 2008 tax returns. And for first-time homebuyers there is an expanded credit available on 2008 tax returns.

Does this new recovery program have any impact on the recovery rebate credit for 2008 tax returns being filed now? No. But the IRS reminds taxpayers and tax preparers to make sure they properly determine eligibility for the recovery rebate credit before they file their 2008 federal tax returns.

Where are more details on the tax provisions of the recovery law?

The IRS will be providing more details on this web site as they become available. A summary of the key provisions is available from the Senate Finance and House Ways and Means committees.

2009 Tax Law Changes

2009 Standard Deductions

Single or MFS - \$5,700

MFJ or QW - \$11,400

HH - \$8,350

**Age 65 and/or blind (per person-per event)

MFJ, QW, or MFS - \$1,100

Single or HH - \$1,400

2009 Personal Exemption - \$3,650 per exemption

Standard Mileage Rate

Business - .55/mile

Medical and Moving - .24/mile

Charitable - .14/mile

Social Security Highlights

Maximum earnings subject to FICA - \$106,800



BUSINESS SERVICES
TAX PREPARATION/BOOKKEEPING

Maximum FICA tax - \$6,621.60

Divorced or Separated Parents

A noncustodial parent claiming an exemption for a child can no longer attach certain pages from a divorce decree or separation agreement instead of Form 8332 if the decree or agreement was executed after 2008. The noncustodial parent will have to attach Form 8332, or a similar statement signed by the custodial parent and whose only purpose is to release a claim to exemption.

Qualifying Child Definition

The following changes to the definition of a qualifying child apply to tax years after 2008:

- A qualifying child must be younger than the taxpayer.
- A child cannot be the taxpayer's qualifying child if he or she files a joint return, unless the return was filed only as a claim for refund.
- If the parents of a child can claim the child as a qualifying child, but not parent so claims the child, no one else can claim the child as a qualifying child unless that person's adjusted gross income (AGI) is higher than the highest AGI of any parent of the child.
- A child is a qualifying child for purposes of the child tax credit only if the taxpayer can claim an exemption for him or her.

Sale of Principal Residence

Gain from the sale of a principal residence is no longer excludable from income if it is allocable to periods where neither the taxpayer nor spouse used the property as a principal residence. For example, if the taxpayer used the home three years as rental property, and then moved into it and used it for two years as a main home before selling the property, then only 40% of the gain is excludable.

