



Client advisor

CURRENT INFORMATION, NEWS AND TRENDS

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The 2009 Recovery Act: Will It Provide the Tax Relief You Need?

The following is an overview of the key changes included in the 2009 American Recovery and Reinvestment Act signed into law on February 17, 2009. Many of the new tax law changes will impact almost everyone, so it is important to stay on top of this significant legislation.

Unemployment – Partially Tax-Free – For 2009, the first \$2,400 of unemployment benefits is tax-free. For married couples, each spouse can exclude the first \$2,400.

AMT Patched Again – For yet another year, Congress has applied a patch to the alternative minimum tax (AMT) to prevent middle-income taxpayers from getting hit by a punitive tax that was originally enacted to counter tax shelters of the wealthy. The AMT exemptions for 2009 have been increased to: \$70,950 for married individuals filing jointly, \$46,700 for unmarried individuals, and \$35,475 for married individuals filing separately.

AMT Relief & Nonrefundable Personal Credits – Nonrefundable personal credits will offset the AMT for 2009. Those credits include the dependent care credit, elderly and disabled credit, education credits, adoption credit, child tax credit, mortgage credit, saver’s credit, certain residential home energy credits, first-time homebuyer credit and plug-in electric vehicle credit.

One-Time Payment to Retirees – Retirees, disabled individuals and Social Security beneficiaries, SSI recipients and disabled veterans receiving benefits from the VA will receive a one-time payment of \$250 in 2009. By the time you read this newsletter, the payments may have already been distributed.

Expanded Child Tax Credit – The earned income threshold for the child tax credit has been substantially lowered from

\$12,550 to \$3,000, thereby expanding the number of low-income taxpayers that will qualify for the refundable portion of this credit in 2009 and 2010.

American Opportunity Credit – This replaces and expands the Hope Credit for 2009 and 2010. It will be available for four years of college expenses, and the maximum credit per student increases to \$2,500 per year. The credit will be based on 100% of the first \$2,000, and 25% of the next \$2,000 of tuition, fees, and course material (including books) expenses paid during the tax year. 40% of the credit is refundable, provided the taxpayer is not: (1) a child under the age of 18 or (2) under the age of 24, a full-time student and is not self-supporting. For higher-income taxpayers, this credit begins to phase out for AGI in excess of \$80,000 (\$160,000 for married couples filing jointly), an increase from the previous phase-out thresholds of \$50,000/\$100,000.

Expanded Earned Income Tax Credit (EITC) – The amount of the EITC is partially based upon the number of the taxpayer’s qualifying children. For 2009 and 2010, a new category of three or more children has been added and, for that category, the credit will be based on 45% of the earned income instead of the 40% which applies to the category for two children. This, in effect, temporarily increases the otherwise allowable EITC for taxpayers with three or more children.

Business Benefits – For those with businesses, both the 50% bonus depreciation and the increased Sec. 179 expense deductions have been extended through 2009. Because of the 50% depreciation, the first-year maximum depreciation of vehicles has also been increased by \$8,000.

Please call this office for additional details on any of these new provisions.

“Making Work Pay” Credit May Reduce Withholding Amount

As part of the tax law passed in February, many taxpayers will be entitled to the new “Making Work Pay” credit. Even though this credit will be calculated in the 2009 tax return, the federal income tax withholding tables used by employers have been adjusted to reflect this new credit in an effort to put the money into working taxpayers’ hands right away.

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Going Green Pays Off with the Home Energy Credits

Tax legislation passed in 2008 reinstated and expanded the residential energy improvement credit for only 2009 (this credit was last available in 2007) and extended and expanded the tax credit for residential solar and fuel-cell equipment through 2016. This gives taxpayers who want to “go green” a chance to offset some of the cost of going green with tax credits.

These are two distinctly different credits with different requirements and limitations. Because of these limitations, there are circumstances where a taxpayer may not benefit from the credits. The following is an overview of these credits, but before entering into a contractual arrangement to install any of these energy items, please contact this office first to verify what the tax benefit might be.

Tax Credit for Residential Energy Improvements – Energy improvements to a principal residence located in the United States and placed in service during 2009 qualify for the residential energy improvements credit. This credit also was available in tax years 2006 and 2007, but not for 2008. Generally, the credit is the cost (up to certain limits) for qualifying heat pumps, boilers, water heaters and fans meeting specific energy-efficient standards certified by the manufacturer.

In addition, a taxpayer may qualify for a credit of 10% of the cost of qualifying insulation, exterior windows including skylights, exterior doors, metal roofs coated with heat-reduction pigments and asphalt roofing with appropriate cooling granules.

However, the total lifetime credit is limited to \$500, of which no more than \$200 can be for window components, \$50 for an advanced main air circulating fan, \$150 for a qualified furnace or hot water boiler, or \$300 for any qualified central air

conditioner, heat pump, or water heater. Installation expenses do not count as part of the cost for determining the credit.

Tax Credit for Residential Solar and Fuel-Cell Equipment –

- **Residential solar equipment** – For property placed in service before the end of 2016, a credit is allowed for 30% of the cost of qualifying solar water heaters up to \$2,000 per year, and a credit subject to the same limits also applies for photovoltaic (electricity-generating) solar panels but the \$2,000 per year limit no longer applies after 2008. The foregoing applies to the taxpayer's first or second homes.
- **Fuel-cell equipment** – In addition, a credit of 30% of the cost is allowed for fuel-cell property up to a maximum credit of \$500 for each half-kilowatt of capacity installed per year on the taxpayer's principal residence.
- **Wind & Geothermal energy equipment** – A 30%-of-cost credit is allowed for qualified systems placed into service before 2016. The credit is limited to \$500 for each half-kilowatt of capacity (maximum \$4,000 for wind turbines and \$2,000 for geothermal heat pumps).

Labor costs for onsite installation and for piping and wiring connections are qualifying costs for these credits. However, the credits do not apply to equipment used to heat swimming pools or hot tubs.

Credit limitations – Although these credits can be used to offset both the regular tax and AMT, they are nonrefundable personal credits that can only reduce a taxpayer's tax to zero, and any remaining balance is not refundable. If the amount of the credit for the residential energy-efficient property credit (i.e., the credit for residential solar and fuel-cell equipment and wind/geothermal energy equipment) exceeds the taxpayer's tax after subtracting other nonrefundable personal credits, the excess can be carried to the next tax year and is added to that year's allowable credit.

Check with this office first to verify the tax benefits before signing on with a contractor or salesperson. It's important to determine your tax benefits before obligating yourself.

Back-to-Work Retirees: What Will it Cost You in Taxes?

With the nation's economy in turmoil, many retired taxpayers are thinking about going back to work to either supplement their retirement income or to rebuild their retirement savings. If this applies to you, there are some tax issues you need to be aware of.

Even though you may already be retired and drawing Social Security benefits, you will still be required to pay FICA and Medicare tax through your employer's payroll withholding (amounts to 7.65% of your earnings). If you have self-employment income, you will have to pay both the employer's and employee's share totaling 15.3%.

If you are thinking about building your retirement savings back up by making tax-deductible retirement contributions, you should be aware that upon reaching age 70^{1/2}, a taxpayer can no longer make contributions to a traditional IRA account. If you are under age 70^{1/2}, you can make deductible traditional IRA contributions up to \$6,000 (\$5,000 if under age 50). However, if you are an active participant in another pension plan (being retired and receiving distributions from a retirement plan is not considered being an active participant), the deductibility of the IRA contributions phases out for adjusted gross incomes (AGIs) between \$55,000 and \$65,000 (\$89,000 and \$109,000 for married filers). Employer-deferred compensation plans, such as 401(k) plans, still allow deductible contributions even after 70^{1/2}. Self-employed individuals can contribute to deductible Keogh and SEP plans without age restrictions.

Required minimum distributions (applicable to taxpayers who have reached age 70^{1/2}) have been suspended for 2009 so that taxpayers do not have to withdraw

from pension plans that have dropped in worth because of declining investment values. This hopefully permits the accounts to regain some of their lost value before a distribution must be made again in 2010. However, the decision to skip the 2009 distribution should be made carefully based on individual circumstances since the distribution could be brought into income with little or no tax for lower-income individuals. On the other hand, retirees in higher tax brackets can benefit from skipping the 2009 distribution. If you are returning to work, the additional income may provide enough current cash flow to enable you to skip the required minimum distribution for 2009.

Social Security benefits can be tax-free, 50% taxable, or 85% taxable based on the taxpayer's other income. Thus, your decision to resume working may, in fact, increase the tax on your SS benefits.

Generally, Social Security (SS) benefits are not taxable until the AGI (without Social Security income) plus 50% of the Social Security income, tax-exempt interest income, and certain other infrequently encountered additions exceed a specific threshold. The threshold is \$32,000 for married taxpayers filing jointly, zero for married taxpayers filing separately, and \$25,000 for all others. As the income increases, the 50% becomes 85%. Taxpayers in this transition range are generally in the 15% tax rate, and each additional \$1 of income could cause as much as \$0.85 of SS benefits to become taxable. This effectively raises the overall tax rate from 15% to 27.75% (15 + (.85 x 15)).

Even though going back to work seems simple enough, it can have some significant and often overlooked tax consequences.

("Making Work Pay" Credit May Reduce Withholding Amount Cont'd...)

However, there is a potential hazard. Since the adjustment is based on each individual's earned income from a particular employer, it does not make allowances for multiple job incomes, spousal income, or other forms of income.

The result could cause a taxpayer's withholding to be reduced inappropriately, which may substantially reduce his or her refund at the end of the year; or, worse yet, cause an unexpected tax due.

You are cautioned to check your federal tax withholding on your paystub before and after the change. Determine the amount of the withholding reduction for each paycheck and then, based on the number of paychecks for the year with the reduced withholding amount, determine the amount of the reduction for the year. If you hold multiple jobs or have a spouse who also works, determine the total reduction for all of the paychecks.

Then compare that amount with the allowable credit, which is 6.2% of your earned income or a maximum of \$400 for a single individual and \$800 for joint filers. The credit phases out for higher-income taxpayers, so you may not even be entitled to the maximum credit. The phase-out is 2% of the taxpayer's modified adjusted gross income in excess of \$75,000 (\$150,000 for joint filers) and is totally phased out at \$95,000 (\$190,000 for joint filers).

So, if your withholding adjustment exceeds the credit, that excess will reduce the refund amount or add to the tax due when the 2009 tax return is prepared. If you feel the adjustment is excessive for your circumstances and you would like this office to run an analysis and/or help you make an adjustment, please call to make an appointment.

"Kiddie Tax" No Longer Just For Kiddies

Years ago, it was the practice of many taxpayers to put investments in their children's names to lessen the tax bite by having the investment's income taxed at the child's rate instead of the parent's higher rate. This tactic became so prevalent that Congress stepped in and passed laws that caused most of a child's investment income to be taxed at the parent's top marginal tax rate, thereby curtailing the benefit of that strategy. Because this provision originally applied to children under the age of 14, it was coined the "Kiddie Tax."

Another favorite tax strategy was to gift appreciated investments, such as stock, to children. The child would then sell the stock after he or she were no longer subject to the Kiddie Tax and pay a lower tax on the gains. Beginning in 2003, this strategy further benefited from the gradual reduction of the capital gains (CG) tax rates through the year 2010. However, with the CG rates dropping to 5% in 2006 and 2007 and then to zero in 2008 through 2010 for taxpayers in the 15% or less marginal tax bracket, Congress took steps to also curtail this strategy by gradually increasing the age at which a child is subject to the Kiddie Tax provisions.

The Kiddie Tax now applies to children under the age of 19 AND full-time students under the age of 24. A child is generally subject to the Kiddie Tax regardless of whether or not he or she qualifies as a dependent of the parents unless neither parent is alive on the last day of the child's tax year, he or she is married and files a joint return, or the child is over the age of 18 and is self-supporting (earned income exceeds one-half the amount of his or her support).

For 2009, the Kiddie Tax rules apply only if the child's investment income for the year exceeds \$1,900. Unfortunately, the definition of "investment" income for purposes of these rules includes all income other than "earned" income. Earned income is income from the child's personal services, such as W-2 income or self-employed income. In addition, under the Kiddie Tax rules, the child is not allowed a deduction for the personal exemption (\$3,650 for 2009), and the standard deduction (\$5,700 for 2009) is allowed only to the extent that the child has "earned" income.

For more specific information regarding your particular circumstances, please give this office a call.

2009 First-Time Homebuyer Credit Drops Repayment Obligation

If you're looking to purchase a home, there's no better time than now. Interest rates are low and, if you are a first-time homebuyer, you can benefit from a limited-time tax break designed to help first-time homebuyers afford the down payment on a home.

The American Recovery and Reinvestment Act of 2009 substantially changed the first-time homebuyer credit that was enacted in 2008 for homes purchased between January 1, 2009 and before December 1, 2009. A first-time homebuyer (the definition is very liberal) can receive a refundable tax credit equal to 10% of the purchase price of the home, but capped at \$8,000 (\$4,000 for married taxpayers filing separately). "Refundable tax credit" means that the credit will offset any tax that is owed and the excess will be refunded on the homebuyer's tax return.

Unlike the 2008 version of the credit, it does not need to be paid back except in cases where the home is sold or ceases to be the taxpayer's principal residence within 36 months of its purchase. The home must be located in the U.S. and not purchased from a close relative. The taxpayer can choose to claim the credit on either his or her 2009 return or the original or amended 2008 return. Taxpayers wishing to take advantage of this provision should act quickly. However, a homebuyer may not claim the credit in anticipation of making a home purchase that has yet to happen; the purchase must be finalized, which is usually at the close of escrow, before the credit may be claimed.

A taxpayer is considered a first-time homebuyer if he or she (or spouse, if married) had no present ownership interest in a principal residence in the U.S. during the three-year period before the purchase of the home to which the credit applies.

The purpose of the credit is to assist lower-income individuals in acquiring their own home. Thus, the credit is reduced or eliminated for higher-income taxpayers. For a married couple filing a joint return, the phase-out range is \$150,000 to \$170,000. For other taxpayers, the phase-out range is \$75,000 to \$95,000. Care should be exercised in selecting which year to take the credit since the phase-out is based on the adjusted gross income (AGI) for the year selected.

In addition to the credit, the tax law also allows first-time homebuyers to make a penalty-free withdrawal of up to \$10,000 from their IRAs for the purchase of a home. Married couples can each withdraw up to \$10,000 from their separate IRA accounts for this purpose. Although the withdrawal is penalty-free, it is still taxable so you should consider carefully the tax ramifications and the impact on your future retirement before invading your IRA accounts.

It is probably appropriate to consult with this office in advance of a home purchase if you or family members are contemplating utilizing the new credit or withdrawing from an IRA.



Tax calendar

June – September

June 15, 2009:

- U.S. citizens living abroad on April 15, 2009 must file a 2008 income tax return (if not already filed) or file for an extension.
- The second installment of your 2009 individual estimated taxes is due. If your income or deductions have significantly changed, you should call this office to determine if any adjustment in estimates is appropriate.

July 2009:

- Time to review your 2009 year-to-date income and expenses to ensure that your estimated tax payments and withholding are adequate to avoid underpayment penalties. There have been a significant number of tax changes for 2009 that can impact your estimated taxes for 2009.

July 31, 2009:

- This is the due date for self-employed individuals and employers to file 5500 series returns for 2008 calendar year benefit plans (including Keogh/HR-10 plans).

September 15, 2009:

- The third installment of your 2009 individual estimated taxes is due.
- This is the due date for filing calendar year 2008 Fiduciary Income Tax (Form 1041), Corporation (Form 1120 and 1120S), and Partnership (Form 1065) returns for which extensions were previously filed.

The purpose of this newsletter is to provide current information on tax, financial and business developments. It suggests general tax planning ideas that may only be appropriate when claiming tax benefits in a manner consistent with the statutes and Congressional purpose. The information and opinions are generalizations and may not apply to all taxpayers and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. Therefore, it is important that you seek appropriate advice before implementing any of the ideas suggested.

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Since You
Asked...



You Asked: I purchased a new car this year and heard that there was a way to write-off the sales tax I paid even if I don't itemize my deductions. Is that true?

Answer: The answer is maybe. Congress included a special provision for 2009 that allows taxpayers to deduct the state and local sales and excise taxes paid on up to \$49,500 of the purchase price of a qualified new car, light truck, motor home or motorcycle without having to itemize their deductions. Used vehicles don't qualify but a pre-2009 model for which you'll be the first-time user will qualify. The vehicle must be purchased after February 16, 2009 and before January 1, 2010 to qualify for the deduction; leased vehicles don't qualify. The amount of the deduction

is phased out for taxpayers whose modified adjusted gross income is between \$125,000 and \$135,000 for individual filers and between \$250,000 and \$260,000 for joint filers.

You Asked: I have always recorded my tax data to the nearest penny. A friend says he just rounds up or down to the nearest dollar. Is this allowed by the IRS?

Answer: The IRS allows taxpayers to round up or down to the nearest dollar. The following example of rounding is provided in the IRS regulations: from \$18.00 through \$18.49 report as \$18 and from \$18.50 through \$18.99 report as \$19. Rounding applies to both individual and business tax data.