ALERT

Will the Stimulus Act Benefit You and Your Family?

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (the Act). In addition to government spending initiatives intended to revive the economy, the nearly $800 billion act provides hundreds of millions of dollars of tax cuts expected to benefit 95% of taxpayers.

Because of adjusted gross income (AGI) phaseouts and other limitations, you may not qualify for many of the new or expanded tax breaks the Act provides. But even if you don't, your children, parents or other loved ones might, so you'll want to be familiar with the Act's tax provisions. The Act also provides help to laid-off workers that may benefit your family.

New tax breaks for many

The Act includes a couple of new tax breaks that will benefit many taxpayers:

New relief for most workers, retirees and other Social Security recipients. For 2009 and 2010, the Act creates the Making Work Pay credit of up to $800 for joint filers and $400 for other filers. The credit generally is phased out for joint filers with AGIs exceeding $150,000 and for other filers with AGIs exceeding $75,000. Unlike last year's "recovery rebate," which was distributed via checks mailed to taxpayers, the new credit will generally be "paid" through a reduction in income tax withholding.

The Act also provides a one-time payment of $250 to:

- Retirees, disabled individuals and SSI recipients receiving benefits from the Social Security Administration
- Railroad Retirement beneficiaries
- Disabled veterans receiving benefits from the U.S. Department of Veterans affairs

Similarly, it provides a one-time refundable tax credit of $250 to certain government retirees who aren't eligible for Social Security benefits. Both the $250 payment and the $250 credit reduce any allowable Making Work Pay credit.

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New sales tax deduction for vehicle purchases. To both help individual taxpayers and spur sales for the beleaguered auto industry, the Act creates a new above-the-line deduction for state and local sales and excise taxes paid on the purchase of new cars, light trucks, motorcycles and recreational vehicles. This means that taxpayers can benefit from the deduction even if they don't itemize.

The deduction is available for vehicles purchased from Feb. 17, 2009, through Dec. 31, 2009. The deduction is not, however, available for tax attributable to vehicle value in excess of $49,500. The deduction also phases out based on AGI, but the limits are higher than those for the Making Work Pay credit: The phaseout begins for joint filers with AGIs exceeding $250,000 and for other filers with AGIs exceeding $125,000.

Note that if the itemized deduction for state and local sales tax is extended, you won't be able to deduct the sales tax on a vehicle purchase *both* above the line and as an itemized deduction — if you're eligible for both, you'll have to choose which one to take. Nevertheless, if you've been holding off on making a vehicle purchase to see if the itemized sales tax deduction will be extended for 2009 but you'd now qualify for the above-the-line deduction, there's probably no reason to wait any longer.

Even if the itemized deduction becomes available, an above-the-line deduction is generally more beneficial, because it reduces your AGI, which affects your eligibility for many other tax breaks. Plus, by not taking the *itemized* sales tax deduction, you'll be eligible to take an itemized deduction for any state and local *income* taxes.

Other breaks are expanded

The bulk of the tax relief for individuals involves expanding existing breaks. Here are the key changes to be aware of:

Credit for first-time homebuyers. Last year, a refundable credit equal to 10% of the purchase price of a principal residence was made available to qualified first-time homebuyers. This credit was set to expire July 1, 2009, but the Act extends its availability to purchases made before Dec. 1, 2009. For qualifying purchases made after Dec. 31, 2008, the Act also increases the maximum credit from $7,500 to $8,000.

Perhaps most significant, the Act eliminates the repayment obligation for taxpayers whose qualifying purchase occurs after Dec. 31, 2008 — except in situations where a home is sold within three years of purchase. For purchases before 2009 that qualified for the credit the taxpayer must repay the credit received, generally over a 15-year period but with no interest. So in those cases this break is more of an interest-free loan from the government than a genuine tax credit.

For purposes of the credit, a first-time homebuyer is someone who has had no ownership interest in a principal residence in the United States during the prior three-year period. The credit starts to phase out for joint filers with AGIs exceeding $150,000 ($75,000 for single filers). It's completely eliminated for joint filers with AGIs exceeding $170,000 ($95,000 for single filers). There are certain other limitations as well.

Even if you don't qualify, your adult children might. So if you've been thinking about making a gift to help them fund a down payment, now may be a great time to do it. In addition to benefiting from the credit, they also can take advantage of low housing prices and low interest rates.

American Opportunity education credit (previously called the Hope credit). For 2009 and 2010, the Act expands this credit to cover 100% of the first $2,000 of tuition and related expenses (including books) and 25% of the next $2,000 of such expenses. The maximum credit is $2,500 per year for the first four years of postsecondary education. (The maximum Hope credit was $1,800 and applied to only the first two years of postsecondary education.) The credit phases out for joint filers with AGIs exceeding $160,000 and for other filers with AGIs exceeding $80,000.

If you don't qualify for this credit because your AGI is too high, your child might. Also keep in mind that both the credit and a tax-free 529 plan or Coverdell Education Savings Account distribution can be taken as long as expenses paid with the nontaxable distribution aren't also used to claim the credit.

529 savings plans. Taxpayers can use these tax-advantaged savings plans to fund college expenses. For federal purposes, contributions aren't deductible, but 529 plan distributions used to pay qualified education expenses — tuition, room, board, mandatory fees and books — are tax free. For expenses paid in 2009 and 2010, the Act expands the definition of qualified education expenses to include computers and computer technology.

529 plan owners with students who are in college this year or will be next year may find it wise to use plan funds to purchase computers as soon as they are eligible, in case the expanded definition isn't extended beyond 2010.

Qualified small business stock gain exclusion. Generally, taxpayers selling qualified small business (QSB) stock are allowed to exclude 50% of their gain as long as they've held the stock for at least five years. (To be a QSB, a business must be engaged in an active trade or business and must not have assets exceeding $50 million.) the Act increases the exclusion to 75% if the stock is issued after Feb. 17, 2009, and before Jan. 1, 2011.

Keep in mind that the taxable portion of the gain will be subject to the lesser of your ordinary marginal rate or 28%, rather than the regular long-term gains rate (currently 15% but scheduled to increase to 20% after 2010). Thus, if the 28% rate applies, the effective rate on the QSB gain would be 7% (28% x 25%).

Investing in QSB stock provides other advantages as well. For example, if you sell QSB stock at a loss and are a joint filer, you may be able to treat up to $100,000 ($50,000 for other filers) as an ordinary, rather than capital, loss — regardless of your holding period. This means you can use it to offset ordinary income, such as salary and interest, reducing your taxes by as much as 35% of the loss.

Or, if within 60 days of selling QSB stock at a gain you buy other QSB stock with the proceeds, you may be able to defer the tax on the gain until you dispose of the new stock. The rolled-over gain reduces your basis in the new stock, but for determining long-term gains treatment the new stock's holding period includes the holding period of the stock you sold.

AMT relief granted early this year

One tax provision affecting individuals that many thought wouldn't be enacted until later in the year is the extension of alternative minimum tax (AMT) relief. The AMT is a separate tax system that limits some deductions and doesn't permit others — you must pay the AMT if your AMT liability exceeds your regular tax liability. Unlike the regular tax system, the AMT system isn't regularly adjusted for inflation. So without an extension of relief, many middle class taxpayers would have to pay AMT for 2009.

The Act provides a one-year "patch" that increases the AMT exemption. For married couples filing jointly, the 2009 exemption is $70,950. For singles and heads of households, it's $46,700, and for married filing separately, it's $35,475. These amounts are up slightly from 2008 but are significantly higher than what they would have been for 2009 without the patch — $45,000, $33,750 and $22,500, respectively.

The patch also expands the AMT income ranges over which the exemptions phase out and only partial exemptions are available. The 2009 phaseout ranges are now $150,000 to $433,800 for married filing jointly, $112,500 to $299,300 for singles and heads of households, and $75,000 to $216,900 for married filing separately. The exemption is completely phased out if AMT income exceeds the top of the applicable range.

Additionally, the Act extends a provision through 2009 that allows certain nonrefundable personal tax credits to provide a benefit against the AMT. These include the dependent care credit, the American Opportunity credit and the Lifetime Learning credit. (The child credit and the adoption credit were already allowed for AMT purposes.)

The Act also excludes from the AMT any income from tax-exempt bonds issued in 2009 and 2010, along with 2009 and 2010 refundings of bonds issued after Dec. 31, 2002, and before Jan. 1, 2009. Previously, tax-exempt interest from certain private activity municipal bonds could trigger AMT liability.

Despite these provisions, many taxpayers will continue to be subject to the AMT until more substantial changes are made. So projecting whether you could be subject to the AMT this year or next is very important. With proper planning, you may be able to time income and deductions to avoid the AMT, or at least reduce its impact.

Energy-related breaks expanded

The Act creates or expands several energy-related breaks for individuals, such as:

- Transit benefits
- Residential energy property credit
- Residential energy-efficient property credit
- Plug-in electric vehicles credit

Help given to laid-off workers

Although much of the Act focuses on working Americans, it also provides some relief for laid-off workers:

Unemployment benefits. For 2009, the Act:

- Extends emergency unemployment compensation, which provides up to 33 additional weeks of benefits to workers who've exhausted their regular benefits
- Increases unemployment compensation by $25 per week
- Suspends federal income tax on the first $2,400 of unemployment benefits per recipient — without this provision, 100% of benefits would be included in a recipient's taxable income

COBRA premium assistance. The Act provides a 65% subsidy for health coverage continuation under COBRA for up to nine months. To be eligible, a worker must be involuntarily terminated between Sept. 1, 2008, and Dec. 31, 2009. Eligible workers who were terminated after Sept. 1 but before Feb. 17, 2009, and failed to elect COBRA coverage because it was too expensive have an additional 60 days to elect coverage and receive the subsidy. Workers who are married filing jointly must attest that their income won't exceed $250,000 ($125,000 for other filers).

Make the most of this complex new law

The Act is a huge piece of legislation, and we've only touched the surface of the most important provisions affecting individuals. Many of the rules are complex, and the Act also contains numerous tax breaks and other provisions affecting businesses. So please contact your LBA professional directly to learn which provisions you may benefit from, and how you can make the most of them.