

Winer & Bevilacqua, Inc.
Certified Public Accountants

2009 has been a very unusual year in many respects...the economy in general, the housing market, the stock markets, not to mention income taxes. In this letter, we will try to explain some of the important changes made to our income taxes during the past year.

What this means for Individuals

First-time Homebuyer Credit Extended and Expanded

The Worker, Homeownership, and Business Assistance Act of 2009 went into effect on November 6, 2009. The Act extends the deadline for qualifying home purchases from November 30, 2009 to April 30, 2010. If a buyer enters into a binding contract by April 30, 2010, the buyer has until June 30, 2010 to settle the purchase. The home buyer credit is no longer exclusively for first-time home buyers and now includes "repeat" buyers.

First-time Homebuyer

A first-time home buyer is a buyer who has not owned a principal residence during the three-year period prior to the purchase. For married taxpayers, the homeownership history of both the taxpayer and the spouse are considered. For example, if you have not owned a home in the past three years, but your spouse has owned a principal residence, *neither you nor your spouse qualifies* for the first-time home buyer credit. Ownership of a vacation home or rental property not used as a principal residence *does not disqualify* a buyer as a first-time home buyer.

The 2009 first-time home buyer tax credit provides a refundable credit of 10% of the home's purchase price, up to a maximum credit of \$8,000 for a single or married filing joint taxpayer or \$4,000 for married individuals filing separately. If the home is sold, converted to business or rental use, or ceases to be the taxpayer's main home within three years of the date of purchase, the credit needs to be repaid.

The IRS reminds taxpayers the credit begins to phase out for those with modified adjusted gross income of more than \$75,000, or \$150,000 for joint filers with home purchases prior to November 6, 2009.

Taxpayers who qualify for the first-time homebuyer tax credit on a home purchased in the United States from January 1, 2009 through November 6, 2009, may claim the credit on their 2008 or 2009 tax return. Those who buy the home after filing their 2008 return may amend the tax return if they wish to claim the credit. If a buyer is using an FHA loan, he may be able to use the credit to help with a down payment. Otherwise, first-time buyers can file for the credit once they close on the home.

For some taxpayers, it may make sense to wait and claim the credit next year when they file the 2009 tax return rather than claiming it on the 2008 tax return. This could benefit taxpayers who might qualify for a higher credit on the 2009 tax return. This could include individuals who have less income in 2009 than 2008 because of a decrease in investment income or a job loss.

For those who purchase a home after November 6, 2009 and enter into a binding contract by April 30, 2010, the purchase must be settled by June 30, 2010 to claim the credit on their 2009 or 2010 individual tax return.

The new extended and expanded law raises the income limits for those who purchase homes after November 6, 2009. The full credit will be available to taxpayers with modified adjusted gross income below \$125,000 (\$225,000 if married filing joint) and is phased out for single taxpayers with modified adjusted gross income between \$125,000 and \$145,000 (\$225,000 and \$245,000 if married filing joint). Those with higher incomes do not qualify.

For homes purchased after November 6, 2009, no credit is allowed in the following situations:

1. You cannot purchase a home from other family members, ancestors (parents, grandparents, etc.), lineal descendants (children, grandchildren, etc.) or your spouse or your spouse's family members;
2. The purchase price of the home is more than \$800,000.
3. A purchaser must be at least 18 years of age on the date of purchase. A married taxpayer is treated as meeting the age requirement if either the taxpayer or the taxpayer's spouse is at least age 18 on the date of the purchase.

Repeat Home Buyer

The law defines a tax credit qualified repeat home buyer ("long-time resident") as a person who has owned and resided in the same home for at least five consecutive years of the eight years prior to the purchase date. For married taxpayers, the law tests the homeownership history of both the home buyer and his/her spouse. This means both spouses must qualify as long-time residents, with at least five years of principal residency for each. Repeat home buyers do not have to purchase a home that is more expensive than their previous home to qualify for the tax credit.

The tax credit is equal to 10% of the home's purchase price up to a maximum of \$6,500. Purchases of homes priced above \$800,000 are not eligible for the tax credit.

The full credit will be available to taxpayers with modified adjusted gross income below \$125,000 (\$225,000 if married filing joint) and is phased out for single taxpayers with modified adjusted gross income between \$125,000 and \$145,000 (\$225,000 and \$245,000 if married filing joint). Those with higher incomes do not qualify.

Energy Credit

The new law increases the energy tax credit for homeowners who make energy efficient improvements to their existing homes. The new law increases the credit rate to 30% of the cost of all qualifying improvements and raises the maximum credit to \$1,500 for improvements placed in service in 2009 and 2010.

The credit applies to improvements such as insulation, energy efficient exterior windows, energy-efficient heating and air conditioning systems, water heaters, furnaces burning natural gas, propane, or oil, stoves using biomass fuel to heat a home or water such as wood, pellets, and plants, hot water boilers, electric heat pump water heaters, certain metal and reflective asphalt shingle roofs, and advanced main air circulating fans. The credit does not apply to newly constructed homes.

The new law also eliminates the cap on the 30% tax credit for alternative energy equipment installed in a home with no cap on the income limit from 2009 through 2016 (for existing homes and newly constructed homes) and is not subject to income phase-outs. Qualifying properties include the principal and secondary residence and rental properties. Renewable energy systems include geothermal heat pumps, solar panels, solar water heaters, and small wind energy systems such as residential small wind turbine, residential fuel cell and microturbine systems.

Please refer to www.energystar.gov for a detailed listing of improvements.

Education Benefits

American Opportunity Credit

Over the next two years, more parents and students will qualify for a tax credit to pay for college expenses.

The law changed the name of the Hope Credit to the American Opportunity Credit. The new credit expands to cover 100% of the first \$2,000 of tuition and required course materials and 25% of the next \$2,000 of expenses. Thus, the total tax credit possible is \$2,500. The tax credit is partially refundable, meaning those with lower income and little or no tax liability could now claim some of the credit. Many of those eligible will qualify for the maximum annual credit of \$2,500 per student. The American Opportunity Credit may be claimed for four years instead of two years of post secondary education. The credit is available to a broader range of taxpayers, including many with higher incomes and those who owe no tax. The tax credit is phased-out for single taxpayers with adjusted gross income above \$80,000 and for married couples filing jointly with adjusted gross income above \$160,000.

529 Plan

Tax-free college savings plans and prepaid tuition programs can be used to buy computer equipment and services for an eligible student during 2009 and 2010. The 529 plans have become a popular way for parents and other family members to save for a child's college education. Though contributions to 529 plans are not deductible for federal income tax purposes, there is also no income limit for contributors.

529 plan distributions are tax-free as long as they are used to pay qualified higher education expenses for a designated beneficiary. Qualified expenses include tuition, required fees, books, supplies, equipment and special needs services. For someone who is at least a half-time student, room and board also qualify.

For 2009 and 2010, computer technology and equipment or internet access and related services to be used by the student while enrolled at an eligible educational institution have been added to the list of qualified expenses.

Software designed for sports, games or hobbies does not qualify, unless it is predominantly educational in nature. In general, expenses for computer technology are not qualified expenses for the American Opportunity Credit, Hope Credit, Lifetime Learning Credit or tuition and fees deduction.

Making Work Pay Tax Credit

This tax credit means more take-home pay for millions of American workers. It is available for 2009 and 2010. This credit equals 6.2% of a taxpayer's earned income. The maximum credit is \$800 for a married couple filing a joint return and \$400 for other taxpayers, is reduced by the amount of any Economic Recovery Payment (\$250 per eligible recipient of social security beneficiaries, supplemental security income, railroad retirement or disabled veterans benefits) or Special Credit for Certain Government Retirees (\$250 per eligible federal or state retiree) that you receive. If you are affected by this reduction, you should review your withholding to ensure that sufficient funds have been withheld to meet your tax obligation. The Making Work Pay tax credit is either phased out or unavailable for higher-income taxpayers. The phase out begins at \$75,000 for single taxpayers and \$150,000 for couples filing a joint return. Since this is an estimated reduction in withholding, you could end up owing more next year when you file your tax return.

Up to \$2,400 in Unemployment Benefits Tax Free in 2009

The first \$2,400 of unemployment benefits an individual receives in 2009 are tax free. This provision applies only to benefits received in 2009. This has provided some relief for laid off workers. Normally, unemployment benefits are fully taxable.

2009 New Car Tax Deduction

The deduction applies to new cars only (pre-owned or used, even if it is "new" to you, do not qualify) purchased between February 17, 2009 and December 31, 2009. The purchase must be completed on or before December 31. If you completed the deal on February 16, 2009, you're out of luck.

The deduction is limited to the sales, local, and excise taxes associated with the purchase. In states that don't have a sales tax, the law provides a deduction for other taxes or fees paid. This deduction is available whether or not a taxpayer itemizes deductions on Schedule A.

The deduction is limited to the taxes and fees paid on up to \$49,500 of the purchase price of an eligible vehicle. The deduction starts to phase out at \$125,000 for individuals and \$250,000 for married couples. Once you reach \$135,000 and \$260,000, respectively, you no longer qualify.

Confused State of the Estate Tax

2009

Estates are afforded a \$3.5 million per person exemption and a 45% top rate.

2010

Under current law, the estate tax will not exist in 2010. Although heirs of large estates may benefit by the repeal of the estate tax, heirs of smaller estate could pay more in income tax compared to the estate tax. Because of the limitations that will be imposed on an heir's ability to "step-up" their basis in inherited assets, heirs may end up paying more in income taxes on the disposition of those inherited assets than they would have paid in estate taxes with an ability to "step-up" the basis of those assets.

2011

Beginning January 1, 2011, the estate tax will again be effective with the top estate tax rate of 55% and a \$1 million exemption.

NOTE:

Although it seems reasonable to assume that proposed legislation to re-enact the estate tax will be passed into law sometime in 2010, it is unclear whether such legislation would be made retroactive to January 1, 2010. The minimum exemption proposed is \$3.5 million per person with a maximum rate of 45%.

Gift Tax

The annual gift tax exclusion amount for 2009 and 2010 is \$13,000. If a donor elects to split gifts with his or her spouse, the first \$26,000 of gifts to an individual during a calendar year is excluded from the gift tax.

All transfers between spouses made during their lifetime are free from gift tax.

2010 Social Security Wage Limit and 401k Contribution Limit

Social Security Wage Limit

Because inflation has been so low, the Social Security Administration will keep the wage base at \$106,800 for 2010. There is no maximum amount on Medicare, which is deducted at 1.45% of gross pay.

401(k) Contribution Limit

The 401(k) contribution limit for 2010 will remain at \$16,500 for those who have not reached the age of 50. For those of you who have reached age 50 or over, the catch up limit is just what it sounds like. The current 401(k) rules allow for plan participants who reach age 50 before the calendar year is over to make additional catch up contribution limits on a pre-tax basis. For 2010, the catch up limit remains at \$5,500.

What this means for Businesses

2009 COBRA Federal Health Subsidy

Workers who have lost their jobs may qualify for a 65% subsidy for COBRA continuation premiums for themselves and family members for up to 15 months.

Eligible individuals who elect COBRA in a timely manner will have to pay 35% of the premium to their former employers.

To qualify, an individual must have been involuntarily terminated between September 1, 2008 and February 28, 2010. Individuals who voluntarily quit employment or who are qualified to partake in other group health coverage (i.e., spouse has health insurance or Medicare) are not eligible for the federal health subsidy.

For those who lost their jobs after September 1, 2008 but failed to initially elect COBRA because it was unaffordable, get an additional 60 days to elect COBRA and receive the subsidy.

This subsidy is phased out for individuals whose modified adjusted gross income exceeds \$125,000 (\$250,000 for married filing joint) down to zero for income exceeding \$145,000 (\$290,000 for married filing joint).

Bonus Depreciation

Businesses recover the cost of capital property over time through depreciation. The Recovery Act allows for immediate write-off of 50% of the cost of eligible property acquired before January 1, 2010. This allows for a higher tax deduction in the first year on purchases of new property providing a current tax incentive to invest in capital property.

Section 179

In addition to the bonus depreciation above, small businesses can quickly recover the entire cost of certain capital expenditures by electing a full write off in the year of acquisition instead of depreciating over time. The amount permitted to be written off in the initial year has been increased to up to \$250,000 for property placed in service during 2009. The limit of \$250,000 is phased out once the capital expenditures incurred exceed \$800,000.

For 2010, current law allows 179 expensing up to \$134,000 with phase out beginning at \$530,000 of capital expenditures. These amounts are adjusted for inflation.

Net Operating Loss Carryback

Generally, small businesses may be able to carryback net operating losses for two years, and forward 20 years. A small business for this purpose is a trade or business, including one conducted in or through a corporation, partnership, or sole proprietorship with average gross receipts of \$15 million or less for the last three years. The new rule is for eligible small businesses that are permitted to carry their 2008 net operating losses back from two years to three, four or up to five years. NOL's must be carried back unless an election is made to carry the loss forward. The NOL may be carried back five years. This could have a significant impact on cash flows allowing businesses to obtain a refund of income taxes paid in earlier years.

Sincerely,

Winer & Bevilacqua, Inc.