The Wealth Advisor

Understanding the New Economic Stimulus Law: How Does It Impact You?

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The Gadzo Law Firm is an estate and tax planning law firm. We use our expertise and knowledge to help families like yours plan for present and future life challenges.

On February 17, 2009, President Obama signed into law the $787 Billion American Recovery and Reinvestment Act of 2009 (ARRA). This new law, designed to stimulate the economy, contains numerous tax provisions that affect individuals and small businesses. This includes some provisions that may not apply to you personally, but may affect your parents, children, and/or grandchildren. The following is a summary of the key provisions for individuals and married couples.

"Making Work Pay" Credit
ARRA provides for an 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. This credit phases out at adjusted gross income (AGI) in excess of $75,000 ($150,000 for married couples filing jointly). Eligible taxpayers can claim the credit as a reduction in the amount of income tax that is withheld from a paycheck, or through a credit on a tax return. Under the paycheck withholding option, workers can expect to see approximately $13.00 per week less withheld from their paychecks starting around June. Next year, the extra take-home pay will be approximately $7.70 per week.

Economic Recovery Payment
ARRA provides for a one-time payment of $250 to retirees, disabled individuals, Social Security beneficiaries, and SSI recipients receiving benefits from the Social Security Administration and Railroad Retirement Board; and to veterans receiving disability compensation and pension benefits from the U.S. Department of Veterans' Affairs. There is no AGI phase-out, and this one-time payment reduces the taxpayer's "Making Work Pay" credit.

Refundable Credit for Certain Federal and State Pensioners
ARRA provides for a one-time refundable tax credit of $250 ($500 for spouses filing jointly where both spouses are eligible) in 2009 to certain government retirees who are not eligible for Social Security benefits. This one-time credit also reduces any allowable "Making Work Pay" credit.

Unemployment Compensation Exclusion
A provision in ARRA temporarily suspends federal income tax on the first $2,400 of unemployment benefits received by a recipient in 2009.

Expanded Tax-Free Expenses and Credits for Students
For college and graduate school students, as well as their parents and grandparents, ARRA makes two important changes.

First, in 2009 and 2010 only, ARRA authorizes you to make distributions from a 529 plan, free of income tax, for the purchase of computer technology or equipment. This includes computers, educational software, internet access, and related services. Prior to ARRA, only distributions for "qualified higher education expenses" were free of income tax. Qualified higher education expenses include tuition, fees, books, supplies, and a limited amount of room and board.

Second, ARRA creates the "American Opportunity Credit," a tax credit for up to four years of college or higher education expenses. Applicable for 2009 and 2010 only, the maximum annual credit is $2,500 per student and includes expenses for required course materials.

Planning Tip: The new American Opportunity credit is available for each college or higher-level student in the household. It is not limited to one credit per household.

Expanded and Increased "First-Time Homebuyer" Credit
Designed to stimulate the real estate market, ARRA provides for a refundable "first-time homebuyer" credit of up to $8,000 ($4,000 for unmarried or married filing separately). "First-time homebuyers" are those who have not owned a principal residence during the three-year period prior to the purchase. For married taxpayers, the law tests the homeownership history of both the homebuyer and his/her spouse.

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 homebuyer tax credit. However, ***unmarried joint purchasers may allocate the credit amount to any buyer who qualifies as a first-time buyer, such as may occur if a parent jointly purchases a home with a son or daughter***. Ownership of a vacation home or rental property not used as a principal residence does not disqualify a buyer as a first-time homebuyer.

To apply, the home purchase must occur before December 1, 2009. If the homebuyer uses the home as his or her (or their) principal residence for 36 months, the homebuyer will not be subject to repayment of any of the credit. This is significant in that prior credits for first-time homebuyers were subject to repayment (for example, over a 15-year period).

Planning Tip: On February 25, 2009, the IRS announced that first-time homebuyers who purchase in 2009 can claim the credit on their 2008 federal tax return. If the home purchase closes after filing of the buyer's 2008 return, the buyer can file an amended 2008 return to claim this credit. Alternatively, first-time homebuyers may claim this credit on their 2009 return.

COBRA Assistance

Under COBRA, a former employee can pay to continue the former employer's health insurance benefits for up to 18 months after separation of service. Typically, the former employee pays 100% of this benefit, unless the employer pays some or all as part of a severance agreement.

Under ARRA, the employer must pay 65% of the cost of COBRA for former employees who:

1. ***involuntarily*** separated from service between September 1, 2008 and December 31, 2009; and
2. participated in their employer's health plan at the time they lost their jobs.

Qualifying employees must pay only 35% of the cost of COBRA coverage. Significantly, the employer-borne 65% of the COBRA cost will not be included in the former employee's gross income. This COBRA subsidy phases out beginning at $125,000 modified AGI for individuals, $250,000 for married taxpayers filing jointly.

Planning Tip: If you or a loved one lost a job between September 1, 2008, and February 17, 2009, even if COBRA coverage was not initially elected, an additional 60 days to elect COBRA coverage and receive the subsidy must now be provided by the previous employer.

Planning Tip: Employers can claim a credit for their 65% of the cost of COBRA coverage on their payroll tax return.

Sales Tax Deduction for Vehicle Purchases

For eligible taxpayers who buy a new car, light truck, motor home or motorcycle in 2009 and pay state and local sales and excise taxes, ARRA permits a deduction for some or all of this tax. This deduction applies regardless of whether the taxpayer itemizes deductions on their tax return.

ARRA limits this deduction to the tax on up to $49,500 of the purchase price of an eligible motor vehicle. The deduction phases out beginning at $250,000 AGI for joint filers, $125,000 for other taxpayers. Purchases before February 17, 2009, are not eligible for this deduction.

Energy Efficiency and Conservation Incentives
Designed to encourage energy efficiency, ARRA provides for a 30% credit (up from 10%) for 2009 and 2010 for the cost of replacing windows and doors with energy efficient ones, installing insulation and installing energy efficient heating and cooling equipment. It also increases the aggregate credit available from $500 to $1,500. There is no maximum credit on:

- Electric and solar water property
- Fuel cells (but the eligible expenditure is limited to $500 [$1,667 for property occupied by more than one person] for each half kilowatt of capacity installed)
- Small wind and geothermal heat pump property

Planning Tip: It appears that taxpayers who had used up their $500 lifetime credit can now take an additional $1,000 credit for qualifying expenditures made during 2009 and 2010.

ARRA also provides for a credit equal to $7,500 (no weight limit) for plug-in electric vehicles and a 10% credit (up to $4,000) for converted plug-in vehicles. Low-speed vehicles receive a 10% credit (up to $2,500).

Planning Tip: The energy efficiency, conservation and plug-in vehicle credits are not subject to AGI phase-outs. Therefore, all taxpayers are eligible for these credits.

Enhanced Child Tax Credits
ARRA increases eligibility for the child tax credit for many taxpayers by lowering the annual threshold to $3,000 from $8,300. This change to the child tax credit applies to 2009 and 2010 only.

Alternative Minimum Tax (AMT) Patch
ARRA provides for a relatively small, one-year "patch" or extension of the exemption from the Alternative Minimum Tax, but this patch will keep millions of taxpayers out of AMT. As a result of this patch, individuals earning approximately $85,000-100,000 and married couples filing jointly earning approximately $150,000-200,000 will be exempt from the AMT in 2009.

Conclusion

The recent economic stimulus law includes numerous credits and incentives for individual taxpayers and small businesses. These provisions primarily impact tax years 2009 and 2010, but some provisions affect 2008 and earlier tax years. By working with your planning team to understand these new provisions and the opportunities they create, you may be able to save significant tax dollars, for yourself and possibly parents, children and grandchildren. Please do not hesitate to contact us if you have any questions.

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