Client Tax Update – 2009 Tax Filing Season

To Our Clients,

The Recovery and Reinvestment Act of 2009 and other federal tax law changes and significant changes to Vermont tax laws continue the proliferation of tax filing complexity. The following are items most likely to impact you and other items we consider important. As always, please feel welcome to contact us to discuss your specific tax situation.

Tax Credits for First-Time (and other) Homebuyers - Eligibility and rules for the First-Time Homebuyer's Credit are complex. The main thing to know is if you purchased a home between January 1, 2009 and November 6, 2009 and had no ownership interest in a home in the 3 years prior to the date of purchase, depending on income you may be eligible for a tax credit equal to the lesser of 10% of the purchase price or $8,000. There is no repayment provision unless the home is sold within 3 years. If you purchase a home between November 7, 2009 and April 30, 2010, the rules above apply with two important modifications; income limits for phase-out of the credit are significantly higher, and the definition of a first-time homebuyer has been broadened to include those owning and occupying the same principal residence for any consecutive 5-year period during the 8-year period ending on the date of purchase of the new residence. The maximum credit for taxpayers meeting the expanded definition of first-time homebuyer is the lesser of 10% of purchase price or $6,500. Both credits are available even if no tax is owed.

Property Tax "Deduction" for Non-Itemizers - All taxpayers are allowed to reduce their taxable income by either a standard deduction based on their filing status or by the total of their itemized deductions. For the first time in 2008, and again in 2009, taxpayers who are unable to itemize deductions (itemized total is less than standard deduction) and who pay property taxes can increase their standard deduction by the amount of property taxes paid, up to $500 for single filers or $1,000 for married taxpayers filing jointly. Also, see Motor Vehicle Sales Tax addition to standard deduction next.

Motor Vehicle Sales Tax Deduction - As an increase to the standard deduction, taxpayers who purchased a **new** vehicle between February 17 and December 31, 2009 can deduct sales tax on the first $49,500 of **each** vehicle purchased, whether or not they itemize deductions. Qualifying vehicles include passenger autos, small trucks, motorcycles, and motor homes. IRS has added Schedule L for deducting this and other items for non-itemizers. Note that if you purchased a new vehicle between January 1 and February 16, you can still deduct the vehicle sales tax if you itemize.

Making Work Pay Credit – New Schedule M (and Warning!) - The *Recovery and Reinvestment Act of 2009* added a new credit for eligible taxpayers for 2009 and 2010. The credit is the lesser of 6.2% of earned income or $400 for single filers, $800 for married filers. The credit is calculated on the new Schedule M and phases out for single, head of household and married separate filers with adjusted gross incomes (AGI) between $75,000 and $95,000, and for married taxpayers with AGI between $150,000 and $190,000. The benefit of the credit was accelerated by IRS revising withholding tables for 2009. Thus, although the 2009 credit is claimed on the 2009 tax return, you have likely already received the benefit during 2009 via lower tax withholding from your wages. Warning: If your income is above the phase-out amounts, the combination of lower tax withholding and ineligibility for the credit may result in a lower refund or a balance due!

Energy Tax Credits Reappear for 2009 and 2010 - The energy tax credits are back for 2009 and 2010 and the old $500 lifetime max is gone. The new credit offers a $1,500 lifetime max with the old limit ignored, even if you already claimed it! Eligible energy efficient property includes insulation, doors, windows, water heaters, and furnaces. Please note the energy tax credits **do not apply** to appliances such as refrigerators, dishwashers, and clothes washers and dryers, even if Energy Star rated.

Education Credits – New and Old - For 2009 and 2010, a new American Opportunity Credit (AOC) has replaced the Hope Credit. The Lifetime Learning Credit (LLC) remains intact and largely unchanged. Both credits essentially cover tuition and related fees, books and course materials and neither allows a credit for room and board. The maximum AOC is $2,500 per student (100% of first $2,000 and 25% of next $2,000) and covers the first 4 years of college. The maximum LLC is $2,000 (20% of up to $10,000) and can be claimed for an unlimited number of years. Both credits phase out based on AGI, and 40% of the AOC is refundable, meaning you get that amount of the credit even if you owe no tax!

Report of Foreign Bank and Financial Accounts - All United States persons who have a financial interest in, or signature or other authority over a foreign financial account must file a report with the Department of Treasury if the value of such account exceeds $10,000 at any time during the calendar year. The report is made by filing a special form; Form TD F 90-22.1 by June 30 of the succeeding year. Penalty for failure to complete and submit this form is a fine up to $500,000 and a jail term up to 5 years. IRS Delegation Order 4-35 stated the IRS intends to enforce penalties!

Vermont Increases Capital Gains Tax - Prior to July 1, 2009, 40% of capital gains was excluded from Vermont income tax. As of that date the exclusion was changed to a flat $2,500. Because the change was made mid-year, 2009 capital gains must be identified by date to determine the correct Vermont tax. Taxpayers age 70 or older as of December 31, 2009 may elect to use the 40% exclusion for the second half of the year.

Vermont Limits State Income Tax Deduction to $5,000 - Legislation enacted in 2009 caps the amount of state income tax deductible on a Vermont income tax return to $5,000. Thus, for example, if you deducted $7,500 of state income tax on your federal tax return, you must add $2,500 back to Vermont taxable income to calculate your Vermont tax liability.

Annual Vermont Homestead Declaration Due April 15, 2010 - Annual Vermont Homestead Declarations (HS-122) are due each April 15. Forms HS-122 can be filed late up to September 1 but will incur a penalty. Homeowners filing after September 1 will **not** be eligible for a school property tax credit and will pay the higher school property tax rate. We prepare Form HS-122 for our clients provided we receive the necessary information (current property tax bill).

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