

## **Important Tax Law Changes for 2009**

### **Economic Recovery Payment**

The \$250 Economic Recovery Payment was paid in 2009 to recipients of certain benefits administered by the Social Security Administration, Department of Veterans Affairs, and the Railroad Retirement Board. Eligible individuals received the payment automatically; they did not have to apply for the payment. Any economic recovery payment received during 2009 is not taxable, but it does reduce any making work pay tax credit.

### **Making Work Pay Tax Credit**

The making work pay tax credit is a refundable tax credit of up to \$400 for working individuals (\$800 for Married Filing jointly). This credit is calculated at a rate of 6.2% of earned income. It is phased out (gradually reduced) for taxpayers with a modified adjusted gross income (AGI) in excess of \$75,000 (\$150,000 for Married Filing Jointly). To be eligible for the credit, taxpayers must have a valid social security number (SSN). For Married Filing Jointly taxpayers, at least one taxpayer must have a valid SSN. Most Form W-2 wage earners have already benefited from the credit with a larger paycheck, as a result of the changes made to the federal income tax withholding tables in early 2009 (to implement the making work pay tax credit). The amount of the credit, however, must still be claimed on the taxpayer's 2009 return (filed in 2010). Generally, Schedule M (Form 1040A or 1040), Making Work Pay and Government Retiree Credits, is used to claim the credit. Taxpayers filing Form 1040EZ do not have to file Schedule M. They will calculate the amount of the credit directly on the Form 1040EZ.

### **Special Credit for Certain Government Retirees**

A one-time refundable credit of \$250 is available in 2009 for certain government retirees who receive a pension from work and are not covered by social security. This onetime credit must be claimed on the 2009 income tax return and is a reduction to any making work pay tax credit. Individuals who receive an economic recovery payment must reduce the government retiree credit by the amount of the payment. Schedule M (Form 1040A or 1040), Making Work Pay and Government Retiree Credits, is used to claim the credit.

### **American Opportunity Tax Credit – Expanded Hope Credit**

For tax years 2009 and 2010, the American opportunity tax credit makes temporary changes to the education credit known as the Hope credit. This new credit modifies the existing Hope credit, making it available to a broader range of taxpayers, including higher income taxpayers and those who owe no tax. It adds required course materials to the list of qualifying expenses and allows the credit to be claimed for four years of post-secondary education instead of two years. The maximum amount of the credit is increased to \$2,500 per student. In addition, 40% of the credit may be refundable. The credit is phased out for taxpayers with a modified AGI between \$80,000 and \$90,000 (\$160,000 and \$180,000 if Married Filing Jointly). Nonresident aliens and taxpayers who can be claimed as dependents on someone else's tax return are not eligible for the credit.

### **Unemployment Compensation**

For 2009, taxpayers can exclude from gross income up to \$2,400 of unemployment compensation received in 2009. Unemployment compensation over \$2,400 is subject to federal income tax.

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### **First-time Homebuyer Credit**

For homes purchased in 2009, taxpayers can qualify for a refundable credit of 10% of the purchase price up to \$8,000 (\$4,000 if Married Filing Separately). Generally, the credit for qualifying home purchases after December 31, 2008, and before December 1, 2009, do not have to be repaid, as long as the home remains the taxpayer's main home for 36 months after the purchase date. The amount of the credit begins to phase out for taxpayers whose modified AGI is more than \$75,000 (\$150,000 if Married Filing Jointly). For purposes of the credit, taxpayers are considered to be first-time homebuyers if they did not own any other main home during the three-year period ending on the date of purchase.

### **Sale of Main Home**

Gain from the sale or exchange of the main home is no longer excludable from income if allocable to periods of nonqualified use. Generally, nonqualified use means any period after 2008 where neither the taxpayer nor spouse (or former spouse) used the property as a main home (with certain exceptions). This issue can be complex and is outside the scope of the volunteer program. Refer taxpayers with "nonqualified use" issues to a professional tax preparer.

### **Definition of Qualifying Child Revised**

For 2009, the following changes have been made to the definition of a qualifying child:

- To be a qualifying child, the child must be younger than the taxpayer, unless the child is permanently and totally disabled.
- A child who files a joint return cannot be a qualifying child, unless the return was filed only as a claim for refund and no tax liability would exist for either spouse on separate returns.
- If the parents of a child can claim the child as a qualifying child but neither parent claims the child, no one else can claim the child as a qualifying child unless that person's AGI is higher than the highest AGI of any parent of the child.
- A taxpayer's child is a qualifying child for purposes of the child tax credit only if the taxpayer can and does claim an exemption for the child.

### **Investment Income of Certain Children**

The amount of taxable investment income a child can have without it being subject to tax at the parent's rate has increased to \$1,900 for 2009. There are some exceptions for taxpayers claiming the Hope credit for a student who attended a school in a Midwestern disaster area in 2009. For more information, see Publication 4492- B, Information for Affected Taxpayers in the Midwestern Disaster Areas, and Publication 970, Tax Benefits for Education.

### **Standard Deduction Amount Increased**

The standard deduction for taxpayers who do not itemize deductions on Schedule A (Form 1040) has increased for 2009:

- \$11,400 – Married Filing Jointly or Qualifying Widow(er)
- \$8,350 – Head of Household
- \$5,700 – Single or Married Filing Separately

### **Deduction Allowed for New Vehicle Purchase**

For 2009, there is an additional deduction for state and local sales and excise tax (including certain fees in states that do not have a sales tax) on the purchase of qualified motor vehicles. A

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qualified motor vehicle must be new and includes a passenger automobile or light truck, a motorcycle, or a motor home. The deduction is limited to eligible taxes and fees paid on the first \$49,500 of the purchase price on the vehicle. The deduction phases out for taxpayers with modified AGI of more than \$125,000 (\$250,000 if Married Filing Jointly). The new vehicle deduction is available to taxpayers who claim the standard deduction, as well as taxpayers who itemize deductions on Schedule A (Form 1040). The new deduction can be used to increase the amount of the standard deduction or it can be taken as an itemized deduction (if the taxpayer is not electing to take the state and local general sales tax deduction).

### Limits Increased for Itemized Deductions

Taxpayers with an AGI above a certain amount may lose part of their itemized deductions. In 2009, this AGI amount is increased to \$166,800 (\$83,400 if Married Filing Separately).

### Exemption Amount Increased

The amount each taxpayer can deduct for each exemption increased to \$3,650 for 2009.

### Phaseout of Exemption Amount

Taxpayers with an AGI above a certain amount may lose part of the benefit of their exemptions. The amount at which the phaseout begins depends upon the filing status.

For 2009, the phaseout begins at:

- \$125,100 – Married Filing Separately
- \$166,800 – Single
- \$208,500 – Head of Household, and
- \$250,200 – Married Filing Jointly or Qualifying Widow(er)

For 2009, each exemption cannot be reduced to less than \$2,433. Do not confuse the deduction for a new vehicle purchase with the “Cash for Clunkers” program. The Car Allowance Rebate System (CARS) or “Cash for Clunkers” program, is handled through the U.S. Department of Transportation, National Highway Traffic Safety Administration, not on a tax return. For more information about “Cash for Clunkers” go to [www.cars.gov](http://www.cars.gov). Taxes and fees paid on purchases before February 17, 2009, are not eligible for this special deduction.

### Standard Mileage Rate

- Business-related mileage - For 2009, the standard mileage rate for the cost of operating a car, van, or pickup/panel truck for business use is 55 cents per mile.
- Medical and move-related mileage - For 2009, the standard mileage rate for the cost of operating a vehicle for medical reasons or as part of a deductible move is 24 cents per mile.
- Charitable-related mileage - For 2009, the standard mileage rate for the cost of operating a vehicle for charitable purposes remains at 14 cents per mile.

### Earned Income Credit (EIC)

#### **Amount of credit increased**

For 2009, the maximum credit is:

- \$3,043 with one qualifying child
- \$5,028 with two qualifying children
- \$5,657 with three or more qualifying children
- \$457 with no qualifying child

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### ***Earned income amount increased***

To be eligible for a full or partial credit, the taxpayer must have earned income of at least \$1 but less than:

- \$35,463 (\$40,463 if Married Filing Jointly) with one qualifying child
- \$40,295 (\$45,295 if Married Filing Jointly) with two qualifying children
- \$43,279 (\$48,279 if Married Filing Jointly) with three or more qualifying children
- \$13,440 (\$18,440 if Married Filing Jointly) with no qualifying child

### ***Investment income amount increased***

Taxpayers whose investment income is more than \$3,100 cannot claim the EIC.

### ***Advance payment of the credit***

Qualifying taxpayers can get advance EIC payments (up to \$1,826) added to their pay, by their employer.

### **Additional Child Tax Credit**

For 2009, the minimum amount of earned income needed to claim the additional child tax credit is reduced to \$3,000.

### **New Rules for Children of Divorced or Separated Parents**

For tax years beginning after July 2, 2008 (the 2009 calendar year for most taxpayers), new rules apply to allow the custodial parent to revoke a release of claim to exemption that was previously released to the noncustodial parent on Form 8332, Release/ Revocation of Release of Claim to Exemption for Child by Custodial Parent, or similar form. The revocation is effective no earlier than the tax year beginning in the calendar year following the calendar year in which the custodial parent provided, or made reasonable efforts to provide, the noncustodial parent with written notice of the revocation. If the custodial parent provides notice of revocation to the noncustodial parent in 2009, the earliest tax year the revocation can be effective is the tax year beginning in 2010. Part III of Form 8332 may be used for this purpose. It must be attached to the tax return for each tax year the child is claimed as a dependent as a result of the revocation.

### ***Post-1984 decree or agreement***

If the divorce decree or separation agreement went into effect after 1984 and before 2009, the noncustodial parent can still attach certain pages from the decree or agreement to the tax return instead of Form 8332. For any decree or agreement executed after 2008, Form 8332 or similar form must be used.

### **Social Security and Medicare Taxes**

The maximum amount of wages subject to the social security tax for 2009 is \$106,800. There is no limit on the amount of wages subject to the Medicare tax.

### **Wage Threshold for Household Employees**

The social security and Medicare wage threshold for household employees is \$1,700 for 2009. This means that if a household employee was paid cash wages of less than \$1,700 in 2009, the taxpayer does not have to report and pay social security and Medicare taxes on that employee's 2009 wages.

### **Income Limits Increased for Student Loan Interest Deduction**

For 2009, the amount of the student loan interest deduction is phased out for taxpayers who are married and file jointly, and whose modified AGI is between \$120,000 and \$150,000. If the

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modified AGI is \$150,000 or more, no deduction is allowed. For filing statuses Single, Head of Household, and Qualifying Widow(er), the student loan interest deduction is phased out for taxpayers whose modified AGI is between \$60,000 and \$75,000. If the modified AGI is \$75,000 or more, no deduction is allowed.

### **Income Limits Increased for Lifetime Learning Credit**

For 2009, the amount of the lifetime learning credit is phased out for taxpayers with a modified AGI between \$50,000 and \$60,000 (\$100,000 and \$120,000 if Married Filing Jointly). If the modified AGI is \$60,000 or more (\$120,000 or more for Married Filing Jointly) no credit is allowed.

### **Qualified Higher Education Expense (Section 529 Accounts)**

For tax years 2009 and 2010, the definition of qualified higher education expenses for tax-free distributions from a qualified tuition program is expanded to include the purchase of computer technology, equipment, and Internet access (including related services) that are to be used by the beneficiary and the beneficiary's family during any of the years that the beneficiary is enrolled at an eligible educational institution. Married taxpayers who file separately do not qualify for the student loan interest deduction.

### **Deductible Long-Term Care Premium Limits Increased**

For 2009, the maximum amount of qualified long-term care premiums includible as medical expenses has increased. Qualified long-term care premiums up to the amounts shown below can be included as medical expenses on Schedule A (Form 1040).

- \$320 - age 40 or under
- \$600 - age 41 to 50
- \$1,190 - age 51 to 60
- \$3,180 - age 61 to 70
- \$3,980 - age 71 and over

### **Income Limits Increased for Reduction of Education Savings Bond Interest Exclusion**

For 2009, the amount of the interest exclusion is phased out for Married Filing Jointly taxpayers or Qualifying Widow(er) taxpayers whose modified AGI is between \$104,900 and \$134,900. If the modified AGI is \$134,900 or more, no deduction is allowed. For Single and Head of Household filing statuses, the interest exclusion is phased out for taxpayers whose modified AGI is between \$69,950 and \$84,950. If the modified AGI is \$84,950 or more, no deduction is allowed.

### **Residential Energy Credits**

#### ***Nonbusiness energy property credit***

The new law reinstates and increases the tax credit for homeowners who make energy efficient improvements to their existing homes. The law increases the credit rate to 30% of the cost of all qualifying improvements and raises the maximum credit limit to \$1,500 for improvements placed in service in 2009 and 2010. The credit applies to improvements such as adding insulation, energy efficient exterior windows and doors, energy-efficient heating and air conditioning systems, and certain roofs. The credit has been expanded to include certain asphalt roofs and stoves that burn biomass fuel.

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### ***Residential energy efficient property credit***

This nonrefundable energy tax credit will help individual taxpayers pay for qualified residential energy efficient property, such as solar hot water heaters, geothermal heat pumps, and wind turbines. The new law removes most of the previously imposed maximum amounts and maintains the 30% credit for the purchase of qualified property. This energy credit is claimed on Part II of Form 5695, Residential Energy Credits. This portion of the energy credit is complex. Refer taxpayers with these expenses to a professional tax preparer. The limit on premiums is for each person. Married taxpayers who file separately do not qualify for the exclusion.

### **Self-Employment Tax**

Self-employment tax consists of two parts, social security and Medicare. The maximum amount of net earnings subject to the social security part of the self-employment tax for tax years beginning in 2009 is \$106,800. All net earnings of at least \$400 are subject to the Medicare part of the tax.

### **IRAs and Other Retirement Plans**

#### ***Temporary Waiver of Required Minimum Distributions (RMDs)***

For 2009, taxpayers are not required to take an RMD from IRAs or most defined contribution plans. This waiver applies to plan participants as well as to beneficiaries. The waiver also applies to taxpayers who turn 70-1/2 in 2009 and delay their 2009 RMD until April 1, 2010. The waiver does not apply to RMDs for 2008, even for taxpayers who turned 70-1/2 in 2008 and choose to take the 2008 RMD by April 1, 2009.

#### ***Modified Adjusted Gross Income (AGI) Limit for Traditional IRA Contributions Increased***

For 2009, if a taxpayer is covered by a retirement plan at work, the deduction for contributions to a traditional IRA is reduced (phased out) if the modified AGI is:

- More than \$89,000 but less than \$109,000 for Married Filing Jointly taxpayers or Qualifying Widow(er),
- More than \$55,000 but less than \$65,000 for a Single or Head of Household, or
- Less than \$10,000 for Married Filing Separately.

If only one spouse is covered by a retirement plan at work, and the taxpayers live together or file a joint return, the deduction is phased out if the modified AGI is more than \$166,000 but less than \$176,000. If the modified AGI is \$176,000 or more, no deduction for contributions to a traditional IRA is allowed.

#### ***Modified AGI Limit for Retirement Savings Contribution Credit Increased***

For 2009, taxpayers may be able to claim the retirement savings contribution credit if their modified AGI is not more than:

- \$55,500 for Married Filing Jointly,
- \$41,625 for Head of Household, or
- \$27,750 for Single, Married Filing Separately, or Qualifying Widow(er).

### **Foreign Earned Income and Housing Exclusions**

For 2009, the maximum Foreign Earned Income Exclusion increased to \$91,400. The base housing amount increased to \$40.07 per day or \$14,624 for the entire calendar year.

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### **Deduction for Credit or Debit Card Convenience Fees**

Taxpayers who pay their income tax (including estimated tax payments) by credit or debit card, can deduct the convenience fee charged by the card processor for using the credit or debit card. The deduction is allowed for the year in which the fee was charged to the card as a miscellaneous itemized deduction on Schedule A (Form 1040) and is subject to the 2% of AGI floor.

### **Decreased Estimated Tax Payments for Qualified Individuals With Small Businesses**

For 2009, qualified individuals with small businesses may be eligible to make smaller estimated tax payments. If the individual qualifies, the required annual payment for 2009 is the smaller of 90% of the tax shown on the 2008 tax return or 90% of the tax shown on the 2009 tax return.

### **Schedule L (Form 1040A or 1040), Standard Deduction for Certain Filers**

Schedule L is a new form that is used to calculate the standard deduction for certain filers. Taxpayers can use this form if they are increasing their standard deduction by certain state or local real estate taxes, new motor vehicle taxes, or a net disaster loss.

### **Schedule M (Form 1040A or 1040), Making Work Pay and Government Retiree Credits**

Schedule M is a new form that is used to figure the making work pay credit and government retiree credit.

### **Refund Options – Savings Bonds**

Taxpayers who receive a tax refund, can use their 2009 tax refund to buy U.S. savings bonds, even without a bank account or an existing account with Treasury. Taxpayers can save all or part of their refund by checking a box when they file their return. Go to [www.irs.gov](http://www.irs.gov) for the latest information and a list of questions and answers.

### **Notes**