Chapter 11: New Legislation

Corrections were made to this workbook through January of 2010. No subsequent modifications were made.

Note. As of the date of this workbook's publication, additional tax legislation is likely. Supplemental information will be posted on the University of Illinois Tax School website after new legislation is enacted.

An unprecedented financial rescue plan and tax relief package (H.R. 1424) was passed by Congress and signed by President Bush on October 3, 2008. H.R. 1424 is divided into three separate sections, each of which includes tax provisions. The sections of this bill are:

- The Emergency Economic Stabilization Act of 2008
- The Energy Improvement and Extension Act of 2008
- The Tax Extenders and Alternative Minimum Tax Relief Act of 2008

The definition of a qualifying child was modified by the passage of H.R. 6893, the Fostering Connections to Success and Increasing Adoptions Act of 2008. This was enacted on October 7, 2008.

In mid-December, the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA) was passed by the House and Senate and sent to President Bush, who signed the bill on December 23, 2008. Congress thought it imperative to have the legislation passed before the end of 2008 in order to assist many businesses in their recovery efforts.

Tax provisions of each bill with the widest impact are analyzed below.

THE EMERGENCY ECONOMIC STABILIZATION ACT OF 2008

EXTENSION OF MORTGAGE FORGIVENESS DEBT RELIEF ACT

The new bill extends provisions of the Mortgage Forgiveness Debt Relief Act for an additional three years. Previously, discharges of up to $2 million of cancellation of debt income (CODI) attributable to the taxpayer's principal residence occurring after 2006 and before 2010 were excluded from income for federal tax purposes. Under the new Act, these provisions expire at the end of 2012.

Only debt acquired for the purchase, construction, or substantial improvement of a principal residence qualifies for the exclusion. The debt must be secured by the residence.

This provision applies to debt discharged between January 1, 2007 and December 31, 2012.

Note. For more detail on the Mortgage Forgiveness Debt Relief Act, see Chapter 13 of the 2008 *University of Illinois Federal Tax Workbook.* This can be found on the accompanying CD.

THE ENERGY IMPROVEMENT AND EXTENSION ACT OF 2008

ENERGY INCENTIVES

The placed-in-service date for IRC §45 renewable electricity energy credit property is extended until December 31, 2010 for most qualifying sources. For wind and coal sources, the extension is through the end of 2009.

The IRC §48 investment tax credit and IRC §25D residential energy-efficient property credit are extended through 2016. The §48 credit now includes geothermal power systems, and the fuel cell credit cap is increased to $1,500 per half-kilowatt of capacity. The $2,000 credit cap on solar electric investments under §25D is removed, and small wind and geothermal investments are added to the list of qualifying property.

H.R. 1424 extends the excise taxes on coal until the Black Lung Disability Trust Fund can repay the total amount borrowed from the general fund, with interest. This provision eliminates the 2014 phaseout of the coal excise tax.

Note. The energy incentives were changed by the enactment of the American Recovery and Reinvestment Act of 2009. See the "Energy Provisions" section later in this chapter.

TRANSPORTATION INCENTIVES

Plug-in Electric Drive Passenger Vehicles

A new tax credit for **plug-in** electric drive passenger vehicles and light trucks with a gross vehicle weight of 8,500 pounds or less ranges between $2,500 and $7,500. The credit is based on $2,500 plus $417 per kilowatt-hour of traction battery capacity in excess of four kilowatt hours. The credit is available for tax years beginning in 2009 and ends after the total number of these vehicles sold in the United States exceeds 250,000.

Higher credits are available for heavier vehicles. The rules are similar to the alternative motor vehicle credit for hybrid vehicles. For business-use vehicles, the credit is claimed as part of the business credit. For personal-use vehicles, the new qualified plug-in electric drive vehicle credit is claimed on Form 8936, *Qualified Plug-in Electric Drive Motor Vehicle Credit*. If a vehicle is used for both business and personal purposes, the credit is allocated between the two categories.

Note. The plug-in vehicle credit was changed by the enactment of the American Recovery and Reinvestment Act of 2009. See the "Energy Provisions" section later in this chapter.

Exemption from Heavy Vehicle Excise Tax

An exemption from the heavy vehicle 12% excise tax is provided for the cost of idling reduction units designed to eliminate the need for truck engine idling at vehicle rest stops or other temporary parking locations. The cost of installation of advanced insulation, which can reduce energy consumption by vehicles carrying refrigerated cargo, is also exempt.

This change applies to sales and installations after October 3, 2008.

Bicycle Commuters

The Act adds bicycle commuting to the types of commuting expenses deductible by an employer and tax-free to the employee. Previously, only van pooling, transit passes, and qualified parking were excludable by the employee.

Employers may give an employee up to $20 per month to reimburse the cost of purchasing, repair, and storage of a bicycle. To qualify for reimbursement, the employee must use the bicycle for a substantial portion of travel between the employee's residence and work. In addition, the employee may not receive any other type of travel reimbursement. This provision applies for bicycle travel reimbursements beginning after tax year 2008.

Example 1. Lance's employer pays employees who commute to work on bicycles $20 for each commuting month. Lance rides his bicycle to work most days from April 1, 2009, to September 30, 2009. The employer pays Lance $120 ($20 × 6). This amount is deductible by the employer and nontaxable to Lance.

Other Energy Extensions

Other incentives include an extension through 2012 of the IRC §168 50% bonus depreciation for cellulosic biomass ethanol production facilities and a 2-year extension of the IRC §179C refinery expensing election.

ALTERNATIVE FUEL INCENTIVES

H.R. 1424 extends through 2009 the IRC §40A $1 per gallon tax credit for biodiesel production, the $1 per gallon credit for biomass-produced diesel, and the $.10 per gallon credit for small producers. Additionally, diesel produced from a mixture of petroleum and biomass is eligible for a $.50 per gallon credit.

The IRC §6426 alternative fuels credit is extended through 2009 for all fuels except hydrogen. The hydrogen credit is set to expire in 2014. In order to continue eligibility for the credit, certain types of qualifying coal production must achieve at least 50% carbon dioxide sequestration as of October 2009.

ENERGY CONSERVATION INCENTIVES

The energy conservation provisions of H.R. 1424 include:

- Changing the allowable recovery period for the cost of "smart" electric meters and grid equipment to 10 years instead of 20 years. A smart meter typically identifies electric consumption in greater detail than a conventional meter. The information is then transmitted back to the power company.
- Extending the deduction for energy-efficient property in commercial buildings through 2013. This includes property installed as part of interior lighting systems; heating, cooling, ventilation, and hot water systems; or building envelope. The property must reduce the building's energy and power costs by at least 50%.
- Expanding the home energy-efficient property credit to include certain biomass-powered stoves and asphalt roofs containing cooling granules placed in service in 2009. The credit is reinstated for 2009 only for other types of property. This includes natural gas, propane, and oil water heaters if they have an energy factor of at least 0.80 or a thermal efficiency of at least 90%. The credit continues to apply to exterior doors and windows, insulation, heat pumps, furnaces, and central air conditioners. This credit was available for 2006 and 2007 purchases, but is not available for 2008 purchases.
- Extending the energy-efficient home tax credit under IRC §45L through 2009. This credit is **only available to contractors** for the manufacture or construction of new qualified homes. To qualify for the $2,000 credit, the home must achieve a 50% energy savings for heating and cooling over a 2004 level. The home must be no more than three stories high.
- Increasing the IRC §45M energy-efficient appliance credit and extending it through 2010. The credit is available to manufacturers of energy-efficient refrigerators, clothes washers, and dishwashers. The new law changes the qualifying standards.
- Allowing 50% bonus depreciation for reuse and recycling equipment. The taxpayer's original use of the property must begin after August 31, 2008. The equipment must perform a process allowing worn or superfluous material to be turned into material that can be used in manufacturing consumer and commercial products. This can include packaging material.

REVENUE PROVISIONS

Revenue provisions of this Act are expected to raise nearly $17 billion. The most prominent of these measures include:

- Freezing the IRC §199 qualified production activities deduction at 6% for gross receipts derived from the sale, exchange, or other disposition of oil, natural gas, or any primary product thereof. The §199 deduction was scheduled to increase to 9% in 2010.
- Beginning in 2011, requiring brokers to report cost basis information for certain stock and other security transactions to the IRS and whether the gains or losses are long-term or short-term. The information will be reported on Form 1099-B, *Proceeds from Broker or Barter Exchange Transactions*. This provision covers corporate stock acquired on or after January 1, 2011. When an average-basis method is permitted for the stock, the acquisition date is on or after January 1, 2012. For other types of specified securities, the applicable acquisition date is on or after January 1, 2013.

  Unless specifically identified by the investment customer, the information is reported on a "first-in first-out basis."

  Beginning in 2009, brokers have until February 15 to file Forms 1099-B.
- Extending the .2% temporary FUTA surtax for the 2009 tax year.

THE TAX EXTENDERS AND ALTERNATIVE MINIMUM TAX RELIEF ACT OF 2008

This section of H.R. 1424 renews many about-to-expire or already expired tax relief provisions, provides a 1-year alternative minimum tax (AMT) patch, offers disaster relief for specified regions, and allows new tax benefits.

EXTENSION OF AMT CREDIT ALLOWANCE FOR INDIVIDUALS WITH LONG-TERM UNUSED CREDITS

This provision helps taxpayers with unused AMT credits, which came about primarily from exercising incentive stock options (ISOs). These taxpayers paid AMT on the value of stocks when they exercised ISOs and later sold the stock at a loss. Congress provided some relief to these taxpayers in 2006.

Under the old law, the AMT credit amount was reduced for taxpayers with AGIs above $100,000 (single) and $150,000 (MFJ). Taxpayers received a refundable credit of the greater of (a) $5,000 or the long-term unused minimum tax credit; or (b) 20% of the credit. The income phaseout is eliminated under the new law.

The new law allows an individual a refundable AMT credit that is the greater of:

- 50% of the long-term unused minimum tax credit, or
- The amount of the refundable AMT credit determined for the previous year.

Example 2. Ernesto exercised an ISO in 2004 and still owns the stock. He paid $20,000 of AMT on his 2004 tax return due to the creation of phantom AMT income. He claimed no minimum tax credits on his 2005 and 2006 returns and claimed a $3,000 minimum tax credit on his 2007 return. His minimum tax credit carryforward to 2008 is $17,000 ($20,000 – $3,000).

Under the revised AMT refundable credit formulas, Ernesto is entitled to claim a 2008 AMT refundable credit of $8,500. The credit is reported on Form 8801, *Credit for Prior Year Minimum Tax*.

Using the revised formula, Ernesto's AMT refundable credit is the greater of:

- $3,000, the prior year refundable AMT credit, or
- $8,500, 50% of the long-term unused minimum tax credit.

Additional provisions are included in the new law. For the 2008 and 2009 tax years, taxpayers who paid underpayment penalties and interest due to exercising ISOs can increase their AMT refundable credit for the amount paid. If the taxpayer has an outstanding AMT tax liability, these amounts are abated, plus penalties and interest.

Note. For more information about AMT Refundable Credits, see Chapter 9 of the 2008 *University of Illinois Federal Tax Workbook* (written before the new law was enacted). This can be found on the accompanying CD.

INDIVIDUAL EXTENDER PROVISIONS

Deduction for State and Local Sales Taxes

Taxpayers can elect to take an itemized deduction for state and local general sales taxes rather than state income taxes. Taxpayers may use the IRS table provided in the 1040 instructions. In addition, they can increase the table amount for any general sales tax paid on the purchase of motor vehicles, boats, or airplanes. If these additional purchases are taxed at a rate higher than the general rate, any excess over the general rate is disregarded. This provision is extended to the end of 2009.

Qualified Tuition and Expenses Deduction

A provision allowing an above-the-line deduction for qualified higher-education expenses was extended to December 31, 2009. The maximum deduction is $4,000 for taxpayers with AGIs of $65,000 or less ($130,000 for MFJ). Taxpayers with income exceeding that limit but under $80,000 ($160,000 MFJ) can deduct up to $2,000 in qualified expenses.

> **Note.** For an in-depth discussion of the Tuition and Fees Deduction, see Chapter 6 of the 2008 *University of Illinois Federal Tax Workbook.* This can be found on the accompanying CD.

Teacher Expense Deduction

The bill extends the provision allowing an above-the-line deduction for up to $250 of unreimbursed material expenses incurred by teachers to the end of 2009. The materials must be used by the teacher in the classroom. To qualify, the taxpayer must work in a school for at least 900 hours during the school year and teach students in grades kindergarten through 12.

Standard Deduction for Non-Itemizer's Real Estate Taxes

A real property tax calculation was added to the standard deduction for taxpayers who do not itemize by the Housing and Economic Recovery Act of 2008. This deduction is the lesser of $500 ($1,000 for MFJ) or the amount allowable as a deduction of state, local, and foreign real property taxes. The provision was set to expire at the end of 2008. It is extended to the end of 2009.

Example 3. Mark and Lauralee file a joint tax return. They have no dependent children and are under age 65. They paid $3,500 of real estate tax in 2008. Their standard deduction of $11,900 is calculated using the worksheet on page 35 of the Form 1040 instructions.

Standard Deduction Worksheet—Line 40 *Keep for Your Records*

Do not complete this worksheet if you checked the box on line 39b; your standard deduction is zero.

1.	Enter the amount shown below for your filing status. • Single or married filing separately—$5,450 • Married filing jointly or Qualifying widow(er)—$10,900 • Head of household—$8,000	**1.** 10,900	
2.	Can you (or your spouse if filing jointly) be claimed as a dependent? ☒ **No.** Skip line 3; enter the amount from line 1 on line 4. ☐ **Yes.** Go to line 3.		
3.	Is your **earned income*** more than $600? ☐ **Yes.** Add $300 to your earned income. Enter the total ☐ **No.** Enter $900	**3.**	
4.	Enter the **smaller** of line 1 or line 3		**4.** 10,900
5.	If born before January 2, 1944, or blind, multiply the number on Form 1040, line 39a, by $1,050 ($1,350 if single or head of household). Otherwise, enter -0-		**5.**
6.	Enter any net disaster loss from Form 4684, line 18a. If more than zero, check the box on Form 1040, line 39c		**6.**
7.	Enter the state and local real estate taxes you paid that would be deductible on Schedule A, line 6, if you were itemizing your deductions. See the instructions for Schedule A, line 6. Do not include foreign real estate taxes	**7.** 3,500	
8.	Enter $500 ($1,000 if married filing jointly)	**8.** 1,000	
9.	Enter the **smaller** of line 7 or line 8. If more than zero, check the box on Form 1040, line 39c		**9.** 1,000
10.	Add lines 4, 5, 6, and 9. Enter the total here and on Form 1040, line 40.		**10.** 11,900

** **Earned income** includes wages, salaries, tips, professional fees, and other compensation received for personal services you performed. It also includes any amount received as a scholarship that you must include in your income. Generally, your earned income is the total of the amount(s) you reported on Form 1040, lines 7, 12, and 18, minus the amount, if any, on line 27.*

IRA Charitable Distributions

A provision of the Pension Protection Act of 2006 (PPA) allowing taxpayers over age 70½ to make tax-free distributions of up to $100,000 per year from their IRAs to qualified charities is extended to the end of 2009. **The contribution must go directly to the charity from the IRA.** The plan may not issue the check payable to the taxpayer, who then makes the donation. The contribution is applied against the taxpayer's required minimum distribution amount.

> **Note.** Taxpayers may want the plan to make the check payable to the charity but mail it to the taxpayer. Then, the taxpayer can hand it to the charity and make sure he gets the appropriate receipt for the donation and that the donation is made timely.

Treatment of Dividends of Regulated Investment Companies (RICs)

A provision permitting RICs to designate certain dividends (or a portion thereof) as interest-related is extended to taxable years of the RIC beginning before January 1, 2010.

BUSINESS EXTENDERS

Research Credit

The research tax credit of 20% of the amount by which a taxpayer's qualified research expenses exceed its base amount for a taxable year is extended to the end of 2009. The new law eliminates the alternative incremental method of calculating the credit. The alternative simplified method of calculating the credit now uses 14%.

New Markets Tax Credit

The new markets credit allowance date is extended through December 31, 2009. The provision allows up to $3.5 billion of qualified equity investments for the year.

15-year MACRS Recovery Period for Qualified Leasehold Improvements

The provision shortening the cost-recovery period of certain leasehold improvements from 39 to 15 years extends to the end of 2009. The straight-line method of depreciation using the half-year convention is required. The 15-year recovery period is not elective. If a taxpayer wants to use a longer recovery period, she must make an election to use ADS.

> **Note.** The Economic Stimulus Act of 2008 allows 50% bonus depreciation for these same improvements. Therefore, a taxpayer can deduct 50% of the cost and then depreciate the remainder over 15 years.

Example 4. Canton Supply spends $350,000 on qualified leasehold improvements to its office in 2009. They are entitled to a total depreciation deduction for that year of $180,833.

$350,000 × 50%	$175,000
($350,000 − $175,000) ÷ 15 ÷ 2	5,833
	$180,833

15-Year MACRS Recovery Period for Restaurant Improvements and Buildings

The provision shortening the cost-recovery period of certain restaurant improvements from 39 to 15 years extends to the end of 2009. Restaurant buildings placed in service in 2009 now qualify as 15-year MACRS property. The straight-line method of depreciation is required. More than 50% of the building's space must be used for the preparation of, and seating for, on-premise consumption of prepared meals.

15-Year MACRS Recovery Period for Qualified Retail Improvement Property

Retail business interior improvements placed in service in 2009 qualify for the 15-year MACRS recovery period using the straight-line method. The building must be at least three years old when the improvement is placed in service. The half-year convention is used unless the mid-quarter convention applies.

The rules are similar to those for qualified leasehold improvements placed in service in 2009. The difference is that this provision applies to owner-occupied buildings. While the mid-month convention does not apply to qualified retail improvement property, it continues to be §1250 property. Therefore, §179 is not applicable.

The 15-year recovery period is required. Taxpayers must elect to use ADS if they want to depreciate the improvements over a longer period. Unlike qualified leasehold improvements, qualified retail improvements are not eligible for 50% bonus depreciation.

Tax Treatment Modification of Payments to Controlling Exempt Organizations

Interest, rent, royalties, and annuities paid to a tax-exempt organization from a controlled entity are generally treated as unrelated business income. Under a provision of the Pension Protection Act of 2006 (PPA), payments to a tax-exempt organization by a controlled entity that were less than fair market value were excludable from the exempt organization's unrelated business income. H.R. 1424 extends this provision to the end of 2009.

Tax Credit for Maintenance of Railroad Tracks

The tax credit of 50% of gross expenditures of short-line railroads for maintaining railroad tracks that they own or lease is extended to the end of 2009. This provision also allows a credit against AMT.

Charitable Deduction Provisions

Four provisions dealing with charitable deductions are extended to December 31, 2009.

1. **Basis Adjustment to S Corporation's Stock for Charitable Contributions of Property**. Before the PPA was enacted, shareholders of an S corporation contributing to a charity reduced their stock basis by their pro-rata share of the contribution's FMV. This was changed under the PPA so that the shareholder's basis reduction in the S corporation stock is equal to the pro-rata share of the shareholder's adjusted basis of the contributed property.

2. **Enhanced Deduction for Qualified Computer Contributions.** This provision encourages businesses to contribute computer equipment and software to elementary, secondary, and post-secondary schools by permitting an enhanced deduction for these contributions.

   C corporations making qualified computer contributions may claim an enhanced deduction, which is defined as the corporation's basis in the contributed property plus one-half of the ordinary income that would have been realized if the property was sold. This enhanced deduction is limited to twice the corporation's basis in the property.

   The computer equipment and technology that may be contributed include computer or peripheral equipment, computer software, and fiber optic cable for computer use. The equipment or technology must be for use within the United States for educational purposes. An eligible donee is one of the following:

   a. An educational organization that normally maintains a regular faculty and curriculum with regularly-enrolled students attending at the place where educational activities are normally held;

   b. A tax-exempt entity organized mainly for purposes of supporting elementary and secondary education;

   c. A private foundation that contributes the property to a donee described in (a) or (b) within 30 days after receiving the contribution; or

   d. A public library.

   Additionally, the property must be donated no later than three years after acquisition by the corporation. If the corporation constructed or assembled the property, the contribution must occur no later than the date construction or assembly is substantially completed.

3. **Enhanced Deduction for Food Inventory Contributions.** This provision allows any taxpayer engaged in a trade or business to take an enhanced deduction for the contribution of food inventory. Food inventory contributions must be items fit for human consumption and must be contributed to a qualified charity or private operating foundation for use in the care of infants, the ill, or the needy.

   The amount of the enhanced deduction for food inventory donations is the basis of the donated item plus one-half of the item's appreciation, not to exceed two times the basis of the donated item. Appreciation of the food item is defined as the amount of gain that would be realized if the donated item was sold at fair market value on the date of the contribution.

   For taxpayers other than C corporations, the total deduction for food inventory contributions is limited to no more than 10% of the taxpayer's net income from the trade or business. However, the 10% limitation is removed for food contributions by qualified ranchers and farmers from October 3, 2008 through December 31, 2008. A qualified rancher or farmer is a taxpayer whose gross income from the trade or business of farming is more than 50% of the taxpayer's gross income for the taxable year.

Observation. Normally, the farmer or rancher will not receive a charitable deduction of the food inventory. Because the food is produced by the taxpayer, it likely has a zero basis. Even though the deduction is limited to twice the basis, two times zero is zero.

4. **Enhanced Deduction for Book Inventory Contributions.** The provision allows C corporations to claim an enhanced charitable deduction for donations of books to public schools. The amount of the enhanced deduction that may be taken is the basis of the donated item plus one-half of the item's appreciation, not to exceed two times the donated item's basis.

   Qualified book contributions are those made to a public school providing elementary or secondary education, which maintain a regular faculty and curriculum and have a regularly-enrolled student body. Additionally, the donee school must certify in writing that:

   - The books are suitable for use in the school's education programs, and
   - The books will actually be used in the school's educational programs.

Work Opportunity Tax Credit for Hurricane Katrina Employees

The work opportunity tax credit for those employed within the core Hurricane Katrina disaster area is extended through August 28, 2009. This applies to those employees hired before August 26, 2009. The credit is 40% of the first $6,000 of qualified wages paid during the first year of employment.

ADDITIONAL TAX RELIEF AND OTHER TAX PROVISIONS

11

5-Year Recovery Period for Certain Farming Machinery and Equipment

A 5-year MACRS recovery period is provided for machinery and equipment (other than grain bins, cotton ginning assets, fences, or other land improvements) used in a farming business. The original use must commence with the taxpayer in 2009, and the assets must be placed in service in 2009. Unless the taxpayer is required to use the ADS depreciation system, the equipment will be depreciated using the 150% declining balance method.

Modification of Preparer Penalties

The standard for imposition of the tax return preparer penalty under §6694 for undisclosed positions is reduced from the strict requirement that a preparer have a reasonable belief that a tax position is "more likely than not" to be sustained on its merits (greater than 50% chance) to one of "substantial authority" for a tax position (1-in-3 chance). The preparer standard for disclosed positions is "reasonable basis." For tax shelters and reportable transactions with significant avoidance or evasion purposes, the tax return preparer standard is a reasonable belief that such a transaction is more likely than not to be sustained on its merits.

For undisclosed and disclosed positions, the new standards are effective for returns prepared after May 25, 2007. The revised standard for tax shelters and reportable transactions applies to returns prepared for tax years ending after October 3, 2008.

Note. For more information on Preparer Penalties, see Chapter 2 of the 2008 *University of Illinois Federal Tax Workbook*. Chapter 2 was written before the change to IRC §6694. This can be found on the accompanying CD.

DISASTER RELIEF

Tax Relief for Midwestern Disaster Area

The bill provides tax relief for victims of floods, severe storms, and tornadoes in federally-declared disaster areas between May 20, 2008 and August 1, 2008, in Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, and Wisconsin. The term "federally-declared disaster area" replaces the former term "Presidentially-declared disaster area." Among the more prominent disaster-related provisions included in this section of the bill are the following:

Tax-Favored Withdrawals. There is a waiver of the 10% early-withdrawal penalty for distributions from an IRA or tax-favored retirement plan (qualified retirement or annuity and §403(b)) that are considered qualified disaster recovery assistance distributions. Other features include the following:

1. The waiver is limited to amounts up to $100,000;
2. The mandatory withholding rules applicable to eligible rollover distributions do not apply;
3. Participants receiving a qualified distribution are allowed to report the income tax resulting from receipt of the distribution ratably over three years; and
4. Amounts distributed may be recontributed to the plan over a 3-year period following the distribution, and these recontributed amounts are not includible in income. For example, if a participant receives a qualified distribution in 2008 and then recontributes the distribution amount in 2009, the participant may file an amended return requesting a refund for the amount taxed on the distribution in 2008.

Recontribution of Home Purchase Withdrawals. Distributions from certain retirement plans for home purchases that were not completed because of a disaster in the Midwestern area may be recontributed to such plans in certain circumstances. The distribution must have been made no more than six months before the applicable disaster date and no later than the applicable disaster date. The distribution must have been intended for the purchase or construction of a principal residence in the Midwestern disaster area. **If the recontribution is made between the applicable disaster date and March 3, 2009, it may be made without tax or penalty.**

Qualified Plan Loans. The limitation on loans from §§401(k), 403(b), or 457 plans is increased up to the lesser of $100,000 (when combined with all other outstanding plan loans) or 100% of the vested benefit for participants who sustained an economic loss in a Midwestern disaster area.

Personal Casualty Loss Limitation Suspension. The Act eliminates the 10% AGI reduction and $100 floor for deductibility of nonbusiness casualty losses resulting from the disasters in the Midwest for taxpayers who itemize. **A taxpayer may elect to report the 2008 loss on his 2007 income tax return.**

Example 5. Ted and Helen live outside of Quincy, Illinois, and were victims of the Midwest floods. Their house and furnishings sustained over $70,000 in damages. Their insurance did not cover $1,000 of the damage, resulting in a $1,000 personal casualty loss. The couple's 2008 AGI is $150,000. Prior to the change in the law, they would not be entitled to a tax deduction because the 10% limitation would apply and the loss did not exceed $15,000 ($150,000 × 10%).

Earned Income Determination. A taxpayer's earned income is used to determine the amount of both the earned income and refundable child tax credits available. Victims of the Midwestern floods are allowed to use their earned income from the previous year to claim these credits.

Dependency Status. Taxpayers will not lose their dependency status, filing status, deductions, or credits because of temporary relocations due to the flooding.

> **Example 6.** Ted and Helen, from **Example 5,** took their two young children to live with grandparents while they rebuilt their house. Consequently, the children lived with Ted and Helen for less than six months during 2008. The Act provides Ted and Helen can claim the children as dependents and receive the refundable child tax credit and earned income credit.

Additional Personal Exemption for Housing Victims. Taxpayers who house up to four dislocated persons from the Midwestern disaster in their principal residences for a minimum of 60 days are allowed an additional personal exemption of $500 per dislocated person, up to a maximum of $2,000. The additional exemption amount is calculated on Form 8914, *Exemption Amount for Taxpayers Housing Individuals Displaced by Midwest Floods.* The amount is then reported on line 42 of Form 1040.

> **Example 7.** Because Ted and Helen's two children lived with their grandparents over 60 days in 2008, the grandparents are entitled to an additional exemption amount of $1,000 (2 × $500) when they file their 2008 income tax return.

Cancellation of Indebtedness Exclusion. Individuals are not taxed on personal debt that is discharged due to damage suffered from the Midwestern disaster. The debt is treated in the same manner as debt forgiveness under IRC §108(a). Therefore, if the taxpayer has any tax attributes such as a net operating loss (NOL) or unused credits, they must be reduced by the amount of the forgiven debt.

> **Example 8.** Ted and Helen had $4,000 of debt remaining on their swimming pool. After the flood, the lender forgave the debt, generating $4,000 of CODI for Ted and Helen. At the time of the flood, the taxpayers had a $3,000 NOL carryforward. Consequently, they must offset the $3,000 NOL tax attribute against the CODI. The remaining $1,000 of debt forgiveness will **not** be taxable. Ted and Helen cannot use any of the NOL to offset other income.

Extension of Replacement Period for Property. Under previous law, taxpayers did not recognize a gain for homes damaged or destroyed because of a federally-declared disaster if the taxpayer replaced the property within a 4-year period. Destroyed business property had to be replaced within two years to avoid gain recognition. This replacement period for nonrecognition of gain is extended to five years for principal residences and business property that was damaged or destroyed in the Midwestern disaster area. The replacement property must be located in the same county.

Employee Retention Credit. Employers with 200 or fewer employees located in the Midwestern disaster area who continue to pay their employees while their businesses are inoperable are eligible for a tax credit based on up to $6,000 wages paid per employee. The tax credit is 40% of qualified wages, or a maximum $2,400 credit per employee ($6,000 × 40%). **The wages must be paid after the applicable disaster date and before January 1, 2009.**

Hope Scholarship and Lifetime Learning Credit Expansion. This provision doubles the maximum Hope credit to $3,600 and the maximum lifetime learning credit to $4,000 for students attending institutions in the Midwestern disaster area. Additionally, room and board expenses qualify for the expanded credit. **The increase applies to tax years 2008 and 2009.**

> **Example 9.** Donyetta was a student at the University of Illinois in 2008. The university is not in a county classified as a federally-declared disaster area. Therefore, her lifetime learning credit for 2008 is limited to $2,000. In January 2009, she transfers to the University of Iowa, which is in a federally-declared disaster area. Donyetta is entitled to a maximum $4,000 lifetime learning credit in 2009 assuming she meets all applicable rules of IRC §25A.

Additional Depreciation. Businesses that suffered damages may claim an additional first-year 50% depreciation deduction of the cost of new real and personal property investments in the disaster area. The property must be placed in service by an eligible taxpayer by the last day of the third calendar year following the applicable disaster date (or the fourth calendar year for nonresidential real and residential rental property). Qualified property does not have to be new, but the original use of the property in the disaster area must be by an eligible taxpayer on or after the applicable disaster date. **This provision pertains to disasters declared after December 31, 2007 and before January 1, 2010.**

Demolition and Debris Removal Costs. For property damaged in the Midwestern storms, demolition and clean-up costs can be currently deducted rather than capitalized as required in non-storm areas. **The current deduction is limited to 50% of the costs incurred between the date of the disaster and December 31, 2010.** The expense must be for structure demolition or debris removal. The property must be located in the disaster area and held for use in a trade or business or as inventory.

Example 10. Lionel, a resident of Iowa City, Iowa, owns a restaurant destroyed by the flood in June 2008. Wanting to remain in the restaurant business, he began investigating possible acquisitions. He saw a riverfront restaurant which was totally destroyed. He contacted the owner and purchased the property and its contents for $80,000. He incurred $30,000 of expense to demolish the building and have the debris removed. He is entitled to a current deduction of $15,000 ($30,000 × 50%). Lionel's basis in the property after demolition is $95,000.

Lionel then erects a restaurant on the lot. He pays $400,000 for the structure. He is entitled to a $200,000 bonus depreciation deduction plus regular depreciation in the year he places the restaurant into service. However, the restaurant must be placed into service no later than December 31, 2012.

§179 Expense Increase. The maximum §179 expense is increased by the lesser of $100,000 or the cost of qualified property. **The increase is available for qualifying expenditures made in the disaster area through the end of 2011.** The phaseout threshold for property placed in service is increased by the lesser of $600,000 or the cost of qualified property.

Example 11. Lionel in **Example 10** pays $200,000 for new restaurant equipment in 2010. Lionel is eligible for up to $233,000 of §179 expense (the regular 2010 limit of $133,000 plus an additional $100,000 for property in a Midwestern disaster area.) This equipment qualifies for a $200,000 §179 deduction assuming Lionel has enough qualifying income.

Note. For details on the §179 expense for businesses located outside the Midwestern disaster area for tax years beginning in 2009, see the "IRC §179 Expensing Election" section later in this chapter.

5-Year NOL Carryback. The NOL carryback period is extended from two to five years for certain losses in the Midwestern disaster area.

Suspension of Limitations on Charitable Contributions. The limitation of 10% of a corporation's taxable income or 50% of an individual's AGI for charitable deductions in a taxable year is temporarily waived for charitable cash contributions to Midwestern disaster relief efforts. **This applies to contributions paid during the period beginning on the earliest applicable disaster date and ending on December 31, 2008.**

Increase in Standard Mileage Rate for Charitable Use. For taxpayers assisting in Midwestern disaster relief efforts, the charitable mileage rate is increased to 70% of the current standard business mileage rate, rounded up to the next higher cent, **beginning on the applicable disaster date and ending on December 31, 2008.** Thus, the charitable mileage rate in effect for the period between May 20, 2008 and July 1, 2008 is $.36 (.505 × 70%). For the period from July 1, 2008 through December 31, 2008, the charitable mileage rate is $.41 (.585 × 70%).

Income Exclusion for Mileage Reimbursements to Charitable Volunteers. Reimbursements for operating expenses of a personal vehicle used in connection with charitable work that are in excess of the statutory charitable mileage rate are generally taxable income to the recipient. However, reimbursements for charitable mileage up to the amount of the standard business mileage rate are not considered taxable income when incurred in connection with the Midwestern disasters.

Hurricane Ike Disaster Tax Relief

The increase in the low-income housing tax credits and the tax-exempt bond rules currently available in the Gulf Opportunity Zone are extended to areas impacted by Hurricane Ike.

National Disaster Relief

Tax relief is provided for **victims of all federally-declared disasters** occurring **between December 31, 2007 and January 1, 2010.**

Casualty Loss Limitation Suspension. The 10% of AGI and $100 floor for deductibility of nonbusiness casualty losses by taxpayers who itemize has been reformed. The bill waives the 10% rule, raises the $100 floor to $500, and allows nonitemizers to use these losses as a standard deduction.

Qualified Disaster Expenses. Under the provisions of H.R. 1424, disaster victims are allowed to expense demolition, clean-up, and environmental remediation expenses.

5-Year NOL Carryback. The NOL carryback period is extended from two to five years for qualified natural diaster areas.

Additional Depreciation. Businesses that suffered damages may claim an additional first-year depreciation deduction of 50% of the cost of new real and personal property investments in a federally-declared disaster area. All depreciation deductions are exempt from AMT. **This provision applies to property placed in service through December 31, 2011, or December 31, 2012 for real property.**

§179 Expense Increase. The maximum §179 expense is increased by the lesser of $100,000 or the cost of qualified property. The increase is available for qualifying expenditures made in the disaster area **through the end of 2011.** The phaseout threshold for property placed in service is increased by the lesser of $600,000 or the cost of qualified property.

Increased Standard Deduction. The bill increases the standard deduction by the amount of the disaster loss for tax years beginning after 2007. The increased standard deduction **does not apply** to victims of the Midwest floods. The loss is reported on Form 4684, *Casualty and Thefts*, line 18c, and then taken to Form 1040, line 40. The box on line 39c must also be checked.

> **Note.** A complete list of the federally-declared disaster areas can be found at **www.irs.gov/newsroom/article/0,,id=98936,00.html.**
>
> IRS Pub. 4492, *Information for Affected Taxpayers in the Midwestern Disaster Areas,* details all of the tax relief available to victims of the Midwestern floods.

11

REVENUE PROVISIONS

There is only one revenue-raising provision in the Tax Extenders section of H.R. 1424. It is expected to raise $25 billion over 10 years.

Inclusion of Deferred Compensation Paid by Tax Indifferent Parties

The bill taxes individuals on a current basis if the individuals receive deferred compensation from a tax indifferent party, such as an offshore corporation in a low or no-tax jurisdiction.

FOSTERING CONNECTIONS TO SUCCESS AND INCREASING ADOPTIONS ACT OF 2008

H.R. 6893 was signed into law by President Bush on October 7, 2008. This Act makes a number of significant improvements to the child welfare system, but the provision that has the most far-reaching tax consequence is the modification in the definition of a qualifying child.

CLARIFICATION OF QUALIFYING CHILD DEFINITION

For tax years beginning after 2008, the following changes are made to the uniform definition of a qualifying child for purposes of the dependency exemption, dependent care, earned income tax credit, and head of household filing status.

1. **Age Test.** The qualifying child must be younger than the taxpayer or be permanently and totally disabled.
2. **Tie-Breaker Rule.** If the parents may claim an individual as a qualifying child, but neither parent actually claims the child, another taxpayer may claim the individual as a qualifying child. However, this other taxpayer must otherwise be eligible to claim the child as a qualifying child and have a higher AGI for the tax year than any parent eligible to claim the child.

Example 12. In 2009, 10-year-old Sally lives with her mother, Rhonda, her father Sam, and her aunt, Rita. Rhonda and Sam are not married. Rhonda's AGI is $25,000, Sam's AGI is $32,000, and Rita's is $30,000. Since Sam's AGI is higher than Rita's, Sally cannot be a qualifying child of Rita for 2009, even if neither Rhonda nor Sam claims Sally on their respective returns.

3. **Child's Marital Status.** A qualifying child cannot file a joint return (except to claim a refund) with a spouse for the taxable year.

Observation. A dependent was already prohibited from filing a joint return under previous law. Although this change does not affect the dependency exemption, it can affect other tax benefits that incorporate the definition of "qualifying child."

4. **Child Tax Credit.** A qualifying child for purposes of the child tax credit must also be the dependent of the taxpayer.

WORKER, RETIREE, AND EMPLOYER RECOVERY ACT OF 2008 (WRERA)

In mid-December, the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA) was passed by the House and Senate and sent to President Bush, who signed the bill on December 23, 2008. Congress thought it imperative to have the legislation passed before the end of 2008 in order to assist many businesses in their recovery efforts.

REQUIRED MINIMUM DISTRIBUTIONS

Many retirement account balances declined substantially in 2008. Congress was concerned that requiring a retiree to take a 2009 required minimum distribution (RMD) based on the December 31, 2008, balance of the account could pose a future hardship. To ease the impact of this situation, the RMD rules for defined contribution retirement plans and individual retirement arrangements (IRAs) are suspended for **2009 only.** This waiver applies to plan participants as well as to beneficiaries. This waiver also applies if a plan participant turns 70½ in 2009 and delays the initial RMD until April 1, 2010.

The intent of the requirements set forth in IRC §401(a)(9) is to encourage taxpayers to receive and pay tax on defined amounts of distributions during the lifetime of the account owner and a designated beneficiary. Distributions must also be made from Roth IRAs after the death of the account owner. To enforce the RMD rules, Congress previously enacted a 50% penalty for failure to take the required distributions. Plan distributions must generally be taken over five years if distributions have not begun when a participant dies. This rule does not apply if distributions commence no later than one year after the participant's death and are payable over the life expectancy of the designated beneficiary. Because 2009 RMDs are waived, 2009 is not included when determining the 5-year period.

Computing RMDs

To compute the required distribution amount, the December 31 prior year account balance is divided by the taxpayer's life expectancy. The life expectancy used for this calculation is found in life-expectancy tables provided by IRS Pub. 590, *Individual Retirement Arrangements (IRAs).* Normally, the first distribution must be taken by April 1 of the later of the year following the year in which the taxpayer attains age 70½ or the year the taxpayer retires. The owner of an IRA must follow the age-70½ rule, as must a qualified plan participant who is a 5% owner of the employer. If the RMD is delayed until April 1 of the year following retirement, a second RMD must be taken before December 31 of the same year.

Law before Waiver

Example 13. Raoul is the owner of an IRA. He attains age 70½ in 2007. Therefore, he may take an RMD in 2007 or wait until 2008 and take two RMDs, the first being taken by April 1.

Example 14. Raoul, from **Example 13,** has an IRA account balance of $1.2 million as of December 31, 2006, and a remaining life expectancy of 27.4 years. If he waits to take the first RMD in 2008, he must take a distribution of $43,796 before April 1, 2008 ($1,200,000 ÷ 27.4). The second payment, due before the end of 2008, is computed using the December 31, 2007, balance.

Law with Waiver

Example 15. Callie turns 70½ in 2009. Because RMDs for 2009 are waived, Callie is not required to take her first RMD on or before April 1, 2010. Her first RMD must be taken by December 31, 2010, based on her retirement account balance as of December 31, 2009, and the distribution period as of her birthday in 2010. Callie attains age 71 on February 1, 2010. Her IRA balance as of December 31, 2009, is $525,000. Callie must take a payment of $19,811 ($525,000 ÷ 26.5) by December 31, 2010.

> **Note.** RMDs for 2008 that were deferred until April 1, 2009, are still required to be taken.

REVENUE-RAISING PROVISIONS

Congress enacted legislation requiring tax bills to be revenue neutral ("pay-go rules"). Recent tax bills have ignored the pay-go rules due to the economic downturn. The WRERA is no exception. However, two revenue-raising provisions are included.

S Corporation Penalty

The WRERA increased the failure-to-file IRC §6699(b) penalty for S corporations from $85/month/shareholder to $89/month/shareholder up to a maximum of 12 months for returns required to be filed after December 31, 2008. The IRS anticipates this will increase revenue by $38 million over the next 10 years.

The penalty can be abated if the corporation can show reasonable cause for its failure to file.

Partnership Penalty

The WRERA also increases the §6698(b)(1) failure-to-file penalty for partnerships from $85/month/partner to $89/month/partner up to a maximum of 12 months for returns filed after December 31, 2008. Congress anticipates this change will generate $42 million of revenue over 10 years.

AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009

President Obama signed the American Recovery and Reinvestment Act of 2009 (ARRA) into law on February 17, 2009. This $787 billion economic stimulus package is designed to:

- Preserve and create jobs and promote economic recovery;
- Assist those most impacted by the recession;
- Provide investments to spur technological advances in science and health;
- Invest in transportation, environmental protection, and other infrastructure; and
- Stabilize state and local government budgets.

Tax relief is the largest component of the ARRA. It is estimated to cost $288 billion and makes more than 300 changes to the Internal Revenue Code. The most far reaching of these provisions are analyzed below.

MAKING WORK PAY CREDIT

Most taxpayers with **earned income**[1] are eligible for the making work pay credit (MWPC). These individuals are allowed a **refundable credit,** which is the lesser of:

- 6.2% of earned income, or
- $400 ($800 for married couples filing jointly).

All taxpayers are eligible for the credit, except for the following:

- Persons who can be claimed as dependents by another taxpayer
- Estates and trusts
- Nonresident aliens

The MWPC is designed to refund the 6.2% employee FICA tax on the first $6,452 of earnings for a single worker and the first $12,904 of earnings for married taxpayers filing jointly.

Phaseout

The MWPC is phased out as shown in the following table:

Filing Status	Modified AGI Phaseout Range
Married filing jointly	$150,000–$190,000
All other filing statuses	75,000–95,000

This credit may be advanced to taxpayers through reduced income tax withholding. The payroll withholding tables have been modified to include the new MWPC. With the reduced withholding, workers are expected to receive approximately $13 more per week in their paychecks. For 2010, the reduced withholding will be approximately $9 weekly.

Self-employed taxpayers who qualify for the credit may reduce the amount of their estimated tax payments in order to receive the credit in advance of Form 1040 filing.

1. Earned income is defined the same as for purposes of the earned income credit; it also includes nontaxable combat pay and net earnings from self employment that are not taken into account in computing taxable income.

The credit allowed to each taxpayer will be calculated on the 2009 and 2010 individual income tax returns using Schedule M, *Making Work Pay and Government Retiree Credit.* Schedule M is attached to Form 1040 or 1040A. A copy of this form follows **Example 16.**

The refundable credit is effective for 2009 **and** 2010.

> **Note.** In Notice 1036-P,[2] the IRS published an optional adjustment procedure which can be used by those paying pensions subject to withholding. This procedure is an approximate offset for the withholding reduction included in the February 2009 withholding tables. Since eligibility for the MWPC requires earned income, which does not include pension payments, there was a concern that using the new withholding tables would result in underwithholding for many retirees receiving pensions.
>
> Some pension payees submitted a Form W-4P, *Withholding Certificate for Pension or Annuity Payments,* after the revised withholding tables were issued. Pension payors using the optional procedure should contact these payees to determine whether they want to alter their withholding.

Economic Recovery Payments

Adults receiving social security, supplemental security income (SSI), railroad retirement, or veterans' benefits will receive $250 in a one-time economic recovery payment. To receive the payment, an individual must have been eligible for one of the qualifying benefit programs for any month in the 3-month period before the date of enactment. Individuals who receive benefits from more than one of the qualifying benefit programs will receive only one $250 economic recovery payment.

> **Note.** Since the ARRA was signed into law in February 2009, an individual must have been eligible for social security, SSI, railroad retirement, or veterans' benefit payments during November 2008, December 2008, or January 2009 in order to receive the $250 economic recovery payment.

If an individual who receives a $250 economic recovery payment is also eligible for the MWPC, the amount of the credit is reduced by the amount of the economic recovery payment the individual received. However, because the $250 economic benefit payment is paid only in 2009, individuals in one of the qualifying benefit programs are entitled to receive the full amount of the MWPC in 2010.

Example 16. Harriet is eligible for social security benefits starting in January 2009. In 2009, she receives a $250 economic recovery payment. Harriet also has a part-time job, from which she earns $7,000 in 2009. Her adjusted gross income for 2009 is $19,000. Her earnings entitle her to a $400 MWPC for 2009 ($7,000 × 6.2% = $434, limited to a maximum of $400). Harriet must deduct the $250 economic recovery payment from her MWPC on her Schedule M (see following). Consequently, she is entitled to a $150 MWPC ($400 – $250).

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2. [www.irs.gov/pub/irs-pdf/n1036p.pdf] Accessed on June 26, 2009.

For Example 16

SCHEDULE M (Form 1040A or 1040)
Department of the Treasury Internal Revenue Service (99)

Making Work Pay and Government Retiree Credits

▶ Attach to Form 1040A, 1040, or 1040NR. ▶ See separate instructions.

OMB No. 1545-0074
2009
Attachment Sequence No. 166

Name(s) shown on return: Harriet
Your social security number: 123 45 6789

1a Important: See the instructions if you can be claimed as someone else's dependent, you have a net loss from a business, your wages include pay for work performed while an inmate in a penal institution, or you are filing Form 1040NR, 2555, or 2555-EZ. Residents of Puerto Rico or American Samoa, see Pub. 570.

Do you (and your spouse if filing jointly) have 2009 wages of more than $6,451 ($12,903 if married filing jointly)?

☒ **Yes.** Skip lines 1a through 3. Enter $400 ($800 if married filing jointly) on line 4 and go to line 5.
☐ **No.** Enter your earned income (see instructions) **1a**

b Nontaxable combat pay included on line 1a (see instructions) **1b**

2	Multiply line 1a by 6.2% (.062)	2	
3	Enter $400 ($800 if married filing jointly)	3	
4	Enter the **smaller** of line 2 or line 3 (unless you checked "Yes" on line 1a)	4	400
5	Enter the amount from Form 1040, line 38*, or Form 1040A, line 22	5	19,000
6	Enter $75,000 ($150,000 if married filing jointly)	6	75,000

7 Is the amount on line 5 more than the amount on line 6?
☒ **No.** Skip line 8. Enter the amount from line 4 on line 9 below.
☐ **Yes.** Subtract line 6 from line 5 . . . . **7**

8 Multiply line 7 by 2% (.02) **8**

9 Subtract line 8 from line 4. If zero or less, enter -0- **9** 400

10 Did you (or your spouse, if filing jointly) receive an economic recovery payment in 2009? You may have received this payment if you received social security benefits, supplemental security income, railroad retirement benefits, or veterans disability compensation or pension benefits (see instructions).

☐ **No.** Enter -0- on line 10 and go to line 11.
☒ **Yes.** Enter the total of the payments received by you (and your spouse, if filing jointly). Do not enter more than $250 ($500 if married filing jointly) . . . **10** 250

11 Did you (or your spouse, if filing jointly) receive a pension or annuity in 2009 for services performed as an employee of the U.S. Government or any U.S. state or local government from work **not** covered by social security? Do not include any pension or annuity reported on Form W-2.

☒ **No.** Enter -0- on line 11 and go to line 12.
☐ **Yes.**
- If you checked "No" on line 10, enter $250 ($500 if married filing jointly and the answer on line 11 is "Yes" for both spouses)
- If you checked "Yes" on line 10, enter -0- (exception: enter $250 if filing jointly and the spouse who received the pension or annuity did not receive an economic recovery payment described on line 10) . . . **11** 0

12 Add lines 10 and 11 . . . . **12** 250

13 Subtract line 12 from line 9. If zero or less, enter -0- **13** 150

14 **Making work pay and government retiree credits.** Add lines 11 and 13. Enter the result here and on Form 1040, line 63; Form 1040A, line 40; or Form 1040NR, line 60 . . . . **14** 150

*If you are filing Form 2555, 2555-EZ, or 4563 or you are excluding income from Puerto Rico, see instructions.

For Paperwork Reduction Act Notice, see Form 1040A, 1040, or 1040NR instructions. Cat. No. 52903Q **Schedule M (Form 1040A or 1040) 2009**

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Example 17. Use the same facts as **Example 16.** Harriet continues to receive social security benefits and work at her part-time job in 2010. If her earnings are again $7,000 in 2010, she will be entitled to the entire $400 MWPC, because no economic recovery payments will be made in 2010.

Credit for Government Retirees

Certain government retirees who are not covered by social security and are not entitled to economic recovery payments are eligible for a refundable one-time $250 tax credit for 2009. Individuals who are also eligible for the MWPC will have that credit reduced by the amount of the credit for government retirees.

EARNED INCOME TAX CREDIT

An enhanced earned income tax credit (EITC) is in effect for 2009 and 2010. For taxpayers with three or more children, the percentage of earned income eligible for the EITC is increased from 40% to 45%. This percentage applies to the first $12,570 of earned income. Thus, the maximum credit allowable for taxpayers with three or more children is increased from $5,028 ($12,570 × 40%) to $5,657 ($12,570 × 45%). This is a $629 increase.

The 2009 EITC for married couples filing joint returns with one or more children phases out between $21,420 and $45,295 of earned income. This is $5,000 more than the phaseout range for single and head of household filers ($16,420 to $40,295). Before enactment of the ARRA, the difference in the phaseout amounts between MFJ and single taxpayers for EITC purposes was $3,000. These phaseout ranges will be adjusted for inflation in 2010.

CHILD TAX CREDIT ENHANCEMENTS

Old Law. Certain taxpayers whose federal income tax liability minus specified nonrefundable credits was less than the regular nonrefundable child tax credit were entitled to a **refundable additional child tax credit**. This refundable credit is computed on Form 8812, *Additional Child Tax Credit*.

The child tax credit is refundable to the extent of 15% of the individual's earned income in excess of a base amount, up to the per child credit amount.

When the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 was passed in October 2008, the 15% of total earned income threshold for the refundable credit amount was lowered from $12,050 to $8,500. This was effective for 2008 only and was to revert to an inflation-adjusted base income of $12,550 in 2009.

New Law. For **2009 and 2010 only,** in order to claim the refundable additional child tax credit, a taxpayer's earned income must exceed $3,000. This is a drop from the $8,500 level for 2008. Taxpayers with three or more children may calculate the refundable portion of the child tax credit as the greater of:

- 15% of earned income in excess of $3,000, or
- The excess of the social security taxes over the taxpayer's EITC.

Example 18. In 2009, Salley, a single mother of two children, earned wages of $9,000. She is eligible to claim the dependency exemption for her children. Salley has no other income for the year. She has no federal income tax liability for 2009 (line 46 of her Form 1040 is zero).

If the threshold for the refundable child tax credit had not been lowered from $12,550 to $3,000, Salley would not be entitled to an additional child tax credit on Form 8812. However, under the new regulations, Salley is eligible for $900 of additional child tax credit.

Salley's completed 2009 Child Tax Credit Worksheet and Form 8812 follow.

For Example 18

Child Tax Credit Worksheet—Line 51

Keep for Your Records

CAUTION

- To be a qualifying child for the child tax credit, the child must be your dependent, **under age 17** at the end of 2009, and meet all the conditions in Steps 1 through 3 on page 17.
- **Do not** use this worksheet if you answered "Yes" to question 1 or 2 on page 42. Instead, use Pub. 972.

Part 1

1. Number of qualifying children: 2 × $1,000. Enter the result. — **1** 2,000

2. Enter the amount from Form 1040, line 38. — **2** 9,000

3. Enter the amount shown below for your filing status.
- Married filing jointly — $110,000
- Single, head of household, or qualifying widow(er) — $75,000
- Married filing separately — $55,000

3 75,000

4. Is the amount on line 2 more than the amount on line 3?

☒ **No.** Leave line 4 blank. Enter -0- on line 5.

☐ **Yes.** Subtract line 3 from line 2.
If the result is not a multiple of $1,000, increase it to the next multiple of $1,000. For example, increase $425 to $1,000, increase $1,025 to $2,000, etc.

4

5. Multiply the amount on line 4 by 5% (.05). Enter the result. — **5** 0

6. Is the amount on line 1 more than the amount on line 5?

☐ **No.** STOP
You cannot take the child tax credit on Form 1040, line 51. You also cannot take the additional child tax credit on Form 1040, line 65. Complete the rest of your Form 1040.

☒ **Yes.** Subtract line 5 from line 1. Enter the result.
Go to Part 2 on the next page. — **6** 2,000

Before you begin Part 2: Figure the amount of any credits you are claiming on Form 5695, Part I; Form 8834, Part I; Form 8910; Form 8936; or Schedule R.

For Example 18

Form **8812** | **Additional Child Tax Credit** | OMB No. 1545-0074 | 2009 | Attachment Sequence No. 47

Department of the Treasury Internal Revenue Service (99)

Complete and attach to Form 1040, Form 1040A, or Form 1040NR.

Name(s) shown on return: **Salley** | Your social security number: **444-44-4444**

Part I — All Filers

1	**1040 filers:** Enter the amount from line 6 of your Child Tax Credit Worksheet on page 43 of the Form 1040 instructions. **1040A filers:** Enter the amount from line 6 of your Child Tax Credit Worksheet on page 38 of the Form 1040A instructions. **1040NR filers:** Enter the amount from line 6 of your Child Tax Credit Worksheet on page 19 of the Form 1040NR instructions. If you used Pub. 972, enter the amount from line 8 of the worksheet on page 4 of the publication.	1	2,000
2	Enter the amount from Form 1040, line 51, Form 1040A, line 33, or Form 1040NR, line 47	2	0
3	Subtract line 2 from line 1. If zero, **stop**; you cannot take this credit	3	2,000
4a	Earned income (see instructions on back) — 4a: 9,000		
b	Nontaxable combat pay (see instructions on back) — 4b:		
5	Is the amount on line 4a more than $3,000? ☐ **No.** Leave line 5 blank and enter -0- on line 6. ☒ **Yes.** Subtract $3,000 from the amount on line 4a. Enter the result — 5: 6,000		
6	Multiply the amount on line 5 by 15% (.15) and enter the result	6	900
	Next. Do you have three or more qualifying children? ☒ **No.** If line 6 is zero, stop; you cannot take this credit. Otherwise, skip Part II and enter the **smaller** of line 3 or line 6 on line 13. ☐ **Yes.** If line 6 is equal to or more than line 3, skip Part II and enter the amount from line 3 on line 13. Otherwise, go to line 7.		

Part II — Certain Filers Who Have Three or More Qualifying Children

7	Withheld social security and Medicare taxes from Form(s) W-2, boxes 4 and 6. If married filing jointly, include your spouse's amounts with yours. If you worked for a railroad, see instructions on back — 7:		
8	**1040 filers:** Enter the total of the amounts from Form 1040, lines 27 and 57, plus any taxes that you identified using code "UT" and entered on the dotted line next to line 60. **1040A filers:** Enter -0-. **1040NR filers:** Enter the total of the amounts from Form 1040NR, line 53, plus any taxes that you identified using code "UT" and entered on the dotted line next to line 57. — 8:		
9	Add lines 7 and 8 — 9:		
10	**1040 filers:** Enter the total of the amounts from Form 1040, lines 64a and 69. **1040A filers:** Enter the total of the amount from Form 1040A, line 41a, plus any excess social security and tier 1 RRTA taxes withheld that you entered to the left of line 44 (see instructions on back). **1040NR filers:** Enter the amount from Form 1040NR, line 63. — 10:		
11	Subtract line 10 from line 9. If zero or less, enter -0-	11	
12	Enter the **larger** of line 6 or line 11 **Next,** enter the **smaller** of line 3 or line 12 on line 13.	12	

Part III — Additional Child Tax Credit

13	**This is your additional child tax credit**	13	900

Enter this amount on Form 1040, line 65, Form 1040A, line 42, or Form 1040NR, line 61.

For Paperwork Reduction Act Notice, see back of form | Cat. No. 10644E | Form **8812** (2009)

11

AMERICAN OPPORTUNITY CREDIT FOR 2009 AND 2010

In 2009 and 2010 there are three different educational credits: American opportunity credit (AOC), Hope credit (for Midwestern disaster area only), and lifetime learning credit.[3] The following changes were made for tax years beginning in **2009 and 2010 only:**

- The maximum amount of the AOC per eligible student is increased from $1,800 to $2,500 (100% of the first $2,000 of qualifying expenses and 25% of the next $2,000).
- The AOC is available for the first four years of post-secondary education in degree or certificate programs (previously, the Hope credit was only available for the first two years of post-secondary education).
- Course materials are added to the definition of qualifying expenses.

Note. Course material is defined as "books, supplies, and equipment needed for a course of study whether or not the materials are purchased from the educational institution as a condition of enrollment or attendance."

- The phaseout range is $80,000 to $90,000 for single taxpayers and $160,000 to $180,000 for married couples filing jointly (for 2008, the ranges were $48,000 to $58,000 (S) and $96,000 to $116,000 (MFJ)).
- The AOC can be claimed against AMT liability.
- Forty percent of the AOC is now refundable, although none of this credit is refundable to those taxpayers subject to the kiddie tax.

Example 19. Carlos is a single father with adjusted gross income of $55,000 in 2009. His daughter, Lexie, attends Ohio State University. Lexie's 2009 qualified educational expenses are $10,000. Carlos is eligible to claim an AOC of $2,500, of which $1,000 ($2,500 × 40%) is refundable.

The following table is a comparison of Carlos' allowable credit under the old law and the new law:

	Old Law	New Law
AGI	$55,000	$55,000
Beginning phaseout amount	$50,000 [a]	N/A
Excess	$5,000	N/A
AGI reduction percentage	$5,000 ÷ $10,000 = 50%	N/A
Max. credit × percentage adjustment	$1,800 × 50% = $900	N/A
Credit allowed	$1,800 − $900 = $900	$2,500
Refundable amount	$0	$2,500 × 40% = $1,000

[a] $50,000 was the 2009 inflation-adjusted beginning of the phaseout range for single taxpayers prior to enactment of the ARRA.

These changes apply for qualifying expenses **paid** in 2009 and 2010 for academic periods beginning in 2009 or 2010 only. Consequently, tuition paid in late 2008 for an academic period starting in 2009 does not qualify for any 2009 education credits; likewise, tuition paid in late 2010 for an academic period starting in 2011 would not qualify for the increased credit.

Note. For an example that includes a completed Form 8863, *Education Credits (American Opportunity, Hope, and Lifetime Learning Credits),* see Chapter 4, Individual Taxpayer Problems.

For information about other education credits, such as the lifetime learning credit, see Chapter 6 of the 2008 *University of Illinois Federal Tax Workbook.* This can be found on the accompanying CD.

3. IRC §25A(i)

Midwestern Disaster Area Expanded Credit Available

As discussed earlier in this chapter, a provision in the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 doubled the maximum Hope credit to $3,600 and the maximum lifetime learning credit to $4,000 for students attending institutions in the Midwestern disaster area in tax years beginning in 2008 and 2009. Additionally, room and board expenses qualify for the doubled credit.

Taxpayers in the Midwestern disaster area eligible for the doubled Hope credit in 2009 can elect to waive the provisions of IRC §25A(i).

> **Note.** See Problem 6, Form 1098-T Tax Issues, in Chapter 4, Individual Taxpayer Problems, for more information regarding the Midwestern disaster area.

SECTION 529 PLAN EXPENSES

Old Law. Under previous law, qualified higher-education expenses for §529 plans consisted of the following:

- Tuition, fees, books, supplies, and equipment required by the educational institution
- Room and board if the student was enrolled at least half-time
- Services required by special-needs students

New Law. For 2009 and 2010 only, tax-free distributions from §529 plans may include computer technology or equipment, Internet access, and related services. The technology and services must be used by the beneficiary of the §529 plan and the beneficiary's family during any of the years that the beneficiary is attending an eligible educational institution. Computer software designed for sports, games, or hobbies is not included unless the software is primarily educational in nature.

Example 20. Johnny Gamepro purchases a new computer using his §529 funds. The computer is the fastest and best available because Johnny wants to use it to play Internet games when he is not in class or studying. While his college classes require a computer, they do not require an ultra high-speed computer. The new legislation does not set any price or configuration limits on computer purchases. Therefore, he may use his §529 plan funds for the purchase of the new computer.

> **Note.** See Chapter 6 in the 2008 *University of Illinois Federal Tax Workbook* for more information about the Hope credit and §529 plans. This can be found on the accompanying CD.

FIRST-TIME HOMEBUYER CREDIT

Old Law. In 2008, a refundable first-time homebuyer credit was introduced for individuals purchasing a home between April 9, 2008, and June 30, 2009. The credit was the lesser of $7,500 or 10% of the purchase price of a principal residence. A first-time homebuyer is defined as an individual (and, if married, the individual's spouse) who has not owned a principal residence in the United States for three years preceding the current purchase date.

Recapture of the credit is without interest and begins the second year after the principal residence is purchased. The taxpayer increases the federal tax liability by 6.66% of the credit amount each year during the recapture period. The recapture period is defined as the 15 taxable years that begin the second year following the year in which the principal residence for which the credit was allowable was purchased. Recapture also occurs if the residence is sold or ceases to be used as a principal residence.

> **Note.** See pages 428–429 in the 2008 *University of Illinois Federal Tax Workbook* for more information on this refundable credit. This can be found on the accompanying CD.

New Law. For 2009, the first-time homebuyer credit was modified and expanded. It was increased to the lesser of $8,000 or 10% of the purchase price and applies to home purchases on or after January 1, 2009, and before December 1, 2009. For married persons filing separately, the maximum credit is $4,000.

There is no recapture on the 2009 homebuyer credit if the taxpayer uses the home as his or his spouse's principal residence for at least 36 months, starting on the date of purchase. If the home ceases to be used as a principal residence during this initial 36-month period, the credit must be recaptured by including the recapture amount as additional tax on the return for the year during which the home ceases to be used as a principal residence. Following are the exceptions to the recapture rule:

1. **The taxpayer sells the home to an unrelated party.** When the home is sold to an unrelated party, the repayment in the year of sale is limited to the amount of gain on the sale. The gain is calculated by reducing the adjusted basis of the home by the amount of the credit.

Example 21. In July 2009, Herschel and Gertie purchased a very small principal residence in Hawaii for $150,000. It qualifies for the $8,000 first-time homebuyer's credit. In May 2010, Gertie's employer transferred her to their Alaska office. Herschel and Gertie sold the Hawaii home for $148,000 to an unrelated party. This resulted in a $6,000 ($148,000 – ($150,000 – $8,000)) profit. Therefore, they must recapture the first-time homebuyer's credit. The recapture amount is $6,000, the lesser of the $8,000 credit or the $6,000 gain.

Example 22. Use the same facts as **Example 21,** except the selling price was $140,000. This results in a $2,000 ($140,000 – ($150,000 – $8,000)) loss. Herschel and Gertie have no credit recapture.

Note. Because the recapture is limited to any profit received on the sale of the principal residence, the government is effectively providing limited insurance if the property declines in value. Up to $8,000 of loss is absorbed by the government.

2. **The home is destroyed, condemned, disposed of under threat of condemnation, or there is an involuntary or compulsory conversion, and the taxpayer acquires a new main home within two years of the event.** No repayment is required. The law does not discuss whether there is recapture if the replacement principal residence costs less than the original property.

3. **As part of a divorce settlement, the home is transferred to a spouse or former spouse.** The spouse who receives the home is responsible for repaying the credit if the spouse sells the home or ceases to use it as a principal residence before the end of the requisite 36-month period.

Example 23. On March 23, 2009, Tara and Terrance purchase a principal residence qualifying for an $8,000 credit. In December 2010, the couple finalizes their divorce, and Tara receives the home as part of the property settlement. On December 25, 2011, Tara remarries and moves into her new husband's home. Because the home she obtained in 2010 is not Tara's principal residence for 36 months, she is liable for recapturing the entire $8,000 credit. However, if she sold the house to an unrelated party, the rules under number 1 above would apply.

4. **The taxpayer dies.** Repayment of the credit is not required. If the deceased taxpayer claimed the credit on a joint return, the surviving spouse must repay half of the credit if the spouse sells the home or ceases to use it as a principal residence before the end of the 36-month period.

Example 24. Use the same facts as **Example 23,** except Terrance died in December 2010 rather than divorcing Tara. When Tara remarries within 36 months of purchasing the home, she is only liable for $4,000 of recapture.

Income Limitations. The credit is subject to a phaseout. For MFJ taxpayers, the phaseout range is $150,000 to $170,000 of modified adjusted gross income (MAGI). The credit is entirely phased out when MAGIs reach $170,000. Taxpayers with other filing statuses are subject to the phaseout for MAGIs between $75,000 and $95,000.

Election to Claim Credit on 2008 Return. A taxpayer can elect to treat a 2009 home purchase as being made on December 31, 2008. This allows the taxpayer to claim the credit on the 2008 tax return. The election is made by checking a box in Part I of Form 5405, *First-Time Homebuyer Credit*, and attaching the form to the taxpayer's original or amended 2008 tax return. This election does not change the start date of the recapture period, which is the home purchase date.

> **Example 25.** First-time homebuyers Lanny and Fanny Lakeside purchased a new home on May 5, 2009. Based on the purchase price and their MAGI, they qualify for the entire $8,000 credit. In order to receive their refundable credit faster, they file an amended 2008 Form 1040 and attach Form 5405.

Form **5405** (Rev. February 2009) Department of the Treasury Internal Revenue Service

First-Time Homebuyer Credit

▶ Attach to Form 1040

OMB No. 1545-0074 **2008** Attachment Sequence No. **163**

Name(s) shown on return	Your social security number
Lanny and Fanny Lakeside	**111 11 1111**

Part I General Information

A Address of home qualifying for the credit (if different from the address shown on return)
200 Shoreline Drive

B Date acquired (see instructions)
Anytown, USA 00000

C If you are choosing to claim the credit on your 2008 return for a main home bought after December 31, 2008, and before December 1, 2009, check here (see instructions) . . . ▶ ☒

Part II Credit

1	Enter the **smaller** of: • $7,500 ($8,000 if you purchased your home in 2009), but only half of that amount if married filing separately, **or** • 10% of the purchase price of the home. If someone other than a spouse also held an interest in the home, enter only your share of this amount (see instructions) . . .			1	**8,000**
2	Enter your modified adjusted gross income (see instructions) . .	2	**65,000**		
3	Is line 2 more than $75,000 ($150,000 if married filing jointly)? **No.** Skip lines 3 through 5 and enter the amount from line 1 on line 6. **Yes.** Subtract $75,000 ($150,000 if married filing jointly) from the amount on line 2 and enter the result . . .	3			
4	Divide line 3 by $20,000 and enter the result as a decimal (rounded to at least three places). **Do not** enter more than 1.000 . . .			4	X .
5	Multiply line 1 by line 4 . . .			5	
6	Subtract line 5 from line 1. This is your **credit.** Enter here and on Form 1040, line 69 . . .			6	**8,000**

> **Observation.** In order to expedite the refund, a taxpayer should consider attaching a copy of the HUD-1 closing statement to Form 5405.[4]

For some taxpayers, it may make more financial sense to wait and claim the homebuyer credit next year when they file the 2009 tax return rather than claiming it on the 2008 tax return. This benefits taxpayers who qualify for a higher credit on the 2009 tax return, including people who have less income in 2009 than 2008 because of factors such as a job loss or a drop in investment income.

4. *Kiplinger Tax Letter*, Vol. 84, No. 17, p. 2 (Aug. 21, 2009).

Homes purchased from a spouse, ancestor, or lineal descendent do not qualify for the credit; neither do homes acquired by gift or inheritance. Homes located outside the United States and purchases made by nonresident aliens are not eligible for the credit.

Homes purchased between April 9, 2008, and December 31, 2008, continue to be governed by the original $7,500 credit and recapture rules.

Allocation of Credit between Unmarried Taxpayers

Two or more taxpayers who are not married and who purchase a principal residence can allocate the first-time homebuyer credit between themselves using any reasonable method.[5] A reasonable method is any method that does not allocate a portion of the credit to an ineligible taxpayer.

One reasonable method suggested by the IRS concerns two unmarried individuals who purchase a home together to use as their principal residence. Each contributes $10,000 toward the down payment. In this case, they could share the credit equally. Another example pertains to one contributing 80% of the down payment and the other 20%. They could share the credit 80–20. Regardless of the situation, any reasonable method is acceptable. If two individuals split the down payment, but only one makes the mortgage payments, it might be reasonable for the individual making the payments to take the full credit.

Example 26. Alfred and Babette purchase a principal residence on May 1, 2009. They are not married to each other, and each has MAGI below $75,000. Alfred contributes $10,000 for a down payment toward the $100,000 purchase price of a residence. Alfred and Babette obtain and are jointly liable for a $90,000 mortgage for the remainder of the purchase price. Each owns a one-half interest in the residence as tenants in common.

Alfred and Babette may allocate the allowable $8,000 credit 55% to Alfred and 45% to Babette based on their contributions toward the purchase price, one-half to each based on their ownership interests in the residence, or using any other reasonable method (for example, the entire credit to Alfred or Babette because both Alfred and Babette are eligible to claim the entire allowable credit).

Note. A March 30, 2009, Treasury Inspector General for Tax Administration (TIGTA) audit report (Audit No. 200940012) states that as of March 6, 2009, taxpayers filed 567,685 returns claiming over $3.9 billion in first-time homebuyer credit. TIGTA's audit identified 38,158 of these claims as coming from taxpayers who may have had ownership in a personal residence within the previous three years.

In an attempt to ensure the accuracy of claims for the first-time homebuyer credit, the IRS developed programming that rejects e-filed tax returns or forwards paper-filed tax returns claiming the credit to the error resolution system function. Additionally, the IRS stated that examination personnel will audit all questionable refund program referral cases with a first-time homebuyer credit. The IRS is also considering a discretionary audit program to evaluate compliance with the 3-year rule and other eligibility criteria.

See the Credits section in Chapter 13, Rulings and Cases, for an analysis of IRS News Release IR-2009-69 (July 29, 2009).

5. IRS Notice 2009-12, IRB 2009-6 (Feb. 9, 2009).

FHA Allows Credit to Be Used toward Purchase Costs

U.S. Housing and Urban Development Secretary Shaun Donovan announced on May 29, 2009, that the Federal Housing Administration (FHA) will allow the first-time homebuyer credit to be applied toward the purchase costs of an FHA-insured home. Homebuyers using FHA-approved lenders can apply the tax credit to their down payment in excess of 3.5% of the home's appraised value or their closing costs.

Before this change was implemented, borrowers applying for an FHA loan were required to make at least a 3.5% down payment on the purchase of a home. Approved lenders can "monetize" the credit, which means that FHA buyers can receive up to $8,000 in short-term financing to be used toward their down payments.[6]

Other Common Eligibility Questions

The following scenarios are shown on the IRS website:[7]

Scenario 1. Amanda qualifies as a first-time homebuyer at the time she purchases a home with Butch, who is not a first-time homebuyer. They marry each other later that same year.

Answer. Eligibility for the credit is determined on the date of purchase. Even though Amanda marries Butch later that year, the full $8,000 credit is available to Amanda.

Scenario 2. Alicia is a single first-time homebuyer. Her parents cosign the mortgage for Alicia. Her parents do not qualify as first-time homebuyers. Everyone's name appears on the mortgage.

Answer. Even though the parents are not first-time homebuyers and cannot claim any portion of the credit, Alicia may claim the entire $8,000 credit if the home is her principal residence.

Scenario 3. Mindy owned her principal residence. Several years ago, she decided to relocate to a rented apartment. She did not sell the former residence and decided to rent it to tenants. Mindy now plans to buy another house and make it her new principal residence.

Answer. A taxpayer who owned rental property within the past three years is still eligible for the credit. The taxpayer cannot have **owned and used a home as her principal residence** within the last three years.

Scenario 4. Stu and Bernadette want to sell the home that Bernadette owned when they got married. Stu has not owned a home within the past three years. Can Stu qualify as a first-time homebuyer for the credit even though Bernadette does not qualify?

Answer. No. The purchase date determines whether a taxpayer is a first-time homebuyer. Since Bernadette had ownership interest in a principal residence within the prior three years, neither taxpayer may take the first-time homebuyer credit. IRC §36(c)(1) requires that the taxpayer and the taxpayer's spouse not have an ownership interest in a principal residence within the prior three years from the date of purchase. Stu may not take the credit even if he files separately.

Scenario 5. Brittany purchased a home on April 24, 2008, while she was separated from her husband. Later in the year, they reconciled and were living together at the end of 2008. She has not owned a home since 2004, but he owned and sold his home in 2006. They remained married the entire time. Is Brittany eligible for the first-time homebuyer credit?

Answer. No. The purchase date determines whether a taxpayer is a first-time homebuyer. Since the husband had ownership interest in a principal residence within the prior three years and the taxpayers were legally married, neither taxpayer may take the first-time homebuyer credit. IRC §36(c)(1) requires that the taxpayer and the taxpayer's spouse not have an ownership interest in a principal residence within the prior three years from the date of purchase. While individuals do not have to be married to get the credit, marriage (and legal separation) imputes ownership of a previous home upon the other spouse. Brittany may not take the credit even if she files separately.

6. [www.hud.gov/news/release.cfm?content=pr09-072.cfm] Accessed on June 26, 2009.

7. [www.irs.gov/newsroom/article/0,,id=206294,00.html] Accessed on August 11, 2009.

Scenario 6. Darron has been estranged from his spouse for over three years and files married filing separately. Darron is uncertain whether his spouse has owned a main home in the last three years. Darron has not. If Darron buys a house in 2009 that otherwise qualifies for the first-time homebuyer credit, can he claim the credit?

Answer. IRC §36(c)(1) requires that the taxpayer and the taxpayer's spouse not have an ownership interest in a principal residence within the three years prior to the date of purchase. While individuals do not have to be married to get the credit, marriage (and legal separation) imputes ownership of a previous home upon the other spouse. If Darron's spouse has not owned a main home in the last three years, then he may claim the credit.

Scenario 7. Jillian is separated from her spouse and considered unmarried, and she qualifies for the unmarried head of household filing status. Her estranged spouse has owned a home in the last three years, but Jillian has not. If she buys a home on May 1, 2009, that otherwise qualifies, can she claim the first-time homebuyer credit?

Answer. No. IRC 36§(c)(1) requires that Jillian and her spouse not have an ownership interest in a principal residence within the three years prior to the date of purchase. While individuals do not have to be married to get the credit, marriage (and legal separation) imputes ownership of a previous home upon the other spouse. Jillian may not take the credit even if she files as head of household.

Scenario 8. Callahan bought a home in August 2008 that needed a lot of work before occupying. He finished the renovations and moved into the home in January 2009. Can Callahan claim the $8,000, since he did not occupy the home until 2009?

Answer. No. Taxpayers who purchase an existing home and renovate the property before moving in are eligible for the first-time homebuyer credit based on the **date of purchase,** not the date of occupancy.

EXCLUSION FOR UNEMPLOYMENT COMPENSATION

Old Law. Unemployment compensation is fully includable in gross income for federal income tax purposes.

New Law. An individual receiving unemployment compensation in 2009 may exclude up to $2,400 from gross income. For a married couple, the exclusion applies separately to each spouse. This provision is in effect for benefits received in 2009 only.

The 2009 Form 1099-G, *Certain Government Payments,* will be mailed in January 2010 to recipients of unemployment compensation. It will report the gross amount of unemployment benefits paid to the individual. Unemployment benefits **in excess of $2,400** are reported on line 19 of the 2009 Form 1040.

> **Example 27.** Henry Timeoff has been unemployed since June 2009. He receives the following Form 1099-G from the state. He will only report $6,100 ($8,500 – $2,400) of unemployment compensation on his 2009 Form 1040.

☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no. **State of Iowa** **Department of Employment Services** **10 Capital Square** **Des Moines, IA 00000**		1 Unemployment compensation $ **8500.00** 2 State or local income tax refunds, credits, or offsets $	OMB No. 1545-0120 **2009** Form **1099-G**	**Certain Government Payments**
PAYER'S federal identification number **11-1111111**	RECIPIENT'S identification number **111-11-1111**	3 Box 2 amount is for tax year	4 Federal income tax withheld $	**Copy C** **For Payer**
RECIPIENT'S name **Henry Timeoff**		5 ATAA payments $	6 Taxable grants $	For Privacy Act and Paperwork Reduction Act Notice, see the **2009 General Instructions for Forms 1099, 1098, 3921, 3922, 5498, and W-2G.**
Street address (including apt. no.) **333 Employee Drive**		7 Agriculture payments $	8 Check if box 2 is trade or business income ▶ ☐	
City, state, and ZIP code **Anytown, USA 00000**		9 Market gain $		
Account number (see instructions)				

Form **1099-G** Department of the Treasury - Internal Revenue Service

ADDITIONAL STANDARD DEDUCTION FOR MOTOR VEHICLE SALES TAX

For qualified **new** motor vehicle purchases between February 17, 2009, and December 31, 2009, state and local sales or excise tax may be deducted as part of the standard deduction. The deduction does not apply to used car purchases or leased vehicles. This deduction is allowable for AMT purposes as well as for regular income tax.

If a taxpayer elects to use sales tax as an itemized deduction, the sales tax paid on a motor vehicle — new or used — is allowable **in addition to the amount provided by the sales tax tables.**

The amount of the allowable additional standard deduction is the portion of the sales or excise tax that applies to the **first $49,500** of the vehicle purchase price.

The **original use** of a qualified motor vehicle must begin with the taxpayer. Qualified vehicles include the following:

1. Passenger vehicles, light trucks, or motorcycles with a gross-vehicle weight rating that does not exceed 8,500 pounds
2. Motor homes

The additional standard deduction is phased out for MFJ taxpayers with MAGIs of $250,000 to $260,000. Taxpayers with other filing statuses are subject to a phaseout for MAGIs of $125,000 to $135,000.

A taxpayer who purchases a qualifying vehicle in 2009 and who itemizes deductions can complete the Schedule A worksheet to calculate the amount of the motor vehicle tax deduction. Taxpayers deducting taxes paid on qualified motor vehicle purchases as part of their standard deduction must complete Schedule L, *Standard Deduction for Certain Filers,* and attach it to their Forms 1040 or 1040A. The additional standard deduction is not available to filers of Form 1040EZ.

Example 28. As a 30th birthday present to himself, Joshua, a single taxpayer with a 2009 MAGI of $130,000, buys a new 2009 Lexus SC 430 for $59,000 on June 30, 2009. He pays sales tax of $5,310 on the vehicle. This is 9% ($5,310 ÷ $59,000) of the purchase price. Joshua's additional standard deduction would be $4,455 ($49,500 × 9%). However, the deduction is limited because Joshua's AGI exceeds the phaseout limit by $5,000 ($130,000 – $125,000). The deduction is therefore reduced by $2,227 (($5,000 ÷ $10,000) × $4,455).

Joshua does **not** itemize deductions on Schedule A. Joshua's completed Schedule L showing his 2009 standard deduction of $7,928 ($5,700 + $2,228) follows.

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For Example 28

SCHEDULE L (Form 1040A or 1040)
Department of the Treasury Internal Revenue Service (99)

Standard Deduction for Certain Filers

▶ Attach to Form 1040A or 1040. ▶ See instructions on back.

OMB No. 1545-0074
2009
Attachment Sequence No. 57

Name(s) shown on return: **Joshua**
Your social security number: 999 11 8888

CAUTION: *File this form **only** if you are increasing your standard deduction by certain state or local real estate taxes, new motor vehicle taxes, or a net disaster loss.*

1	Enter the amount shown below for your filing status. • Single or married filing separately—$5,700 • Married filing jointly or Qualifying widow(er)—$11,400 • Head of household—$8,350	1	5,700		
2	Can you (or your spouse if filing jointly) be claimed as a dependent? ☒ **No.** Skip line 3; enter the amount from line 1 on line 4, and go to line 5. ☐ **Yes.** Go to line 3.				
3	Is your earned income (defined on the back) more than $650? ☐ **Yes.** Add $300 to your earned income. Enter the total ☐ **No.** Enter $950	3			
4	Enter the **smaller** of line 1 or line 3			4	5,700
5	Multiply the number on Form 1040, line 39a, or Form 1040A, line 23a, by $1,100 ($1,400 if single or head of household). If blank, enter -0-			5	0
6	Form 1040 filers only, enter any net disaster loss from Form 4684, line 18			6	
7	Enter the state and local real estate taxes that would be deductible on Schedule A, line 6, if you were itemizing your deductions. **Do not** include foreign real estate taxes (see instructions)	7	0		
8	Enter $500 ($1,000 if married filing jointly)	8	500		
9	Enter the smaller of line 7 or line 8			9	0
10	Did you (or your spouse if filing jointly) pay any state or local sales or excise taxes in 2009 for the purchase of a new motor vehicle **after** February 16, 2009 (see instructions)? ☐ **No.** Skip lines 10 through 20 and go to line 21. ☒ **Yes.** If Form 1040, line 38, or Form 1040A, line 22, is less than $135,000 ($260,000 if married filing jointly), enter the amount of these taxes paid. Otherwise, skip lines 10 through 19, enter -0- on line 20, and go to line 21	10	5,310		
11	Enter the purchase price (before taxes) of the new motor vehicles (see instructions)	11	59,000		
12	Is the amount on line 11 more than $49,500? ☐ **No.** Enter the amount from line 10. ☒ **Yes.** Enter the portion of the tax from line 10 that is attributable to the first $49,500 of the purchase price of each new motor vehicle (see instructions)	12	4,455		
13	Enter the amount from Form 1040, line 38, or Form 1040A, line 22	13	130,000		
14	Form 1040 filers only, enter the total of any— • Amounts from Form 2555, lines 45 and 50; Form 2555-EZ, line 18; and Form 4563, line 15, and • Exclusion of income from Puerto Rico	14			
15	Add lines 13 and 14	15	130,000		
16	Enter $125,000 ($250,000 if married filing jointly)	16	125,000		
17	Is the amount on line 15 more than the amount on line 16? ☐ **No.** Skip lines 17 through 19, enter the amount from line 12 on line 20, and go to line 21. ☒ **Yes.** Subtract line 16 from line 15	17	5,000		
18	Divide line 17 by $10,000. Enter the result as a decimal (rounded to at least three places). If the result is 1.000 or more, enter 1.000	18	. 50		
19	Multiply line 12 by line 18	19	2,227		
20	Subtract line 19 from line 12			20	2,228
21	Add lines 4, 5, 6, 9, and 20. Enter the total here and on Form 1040, line 40a, or Form 1040A, line 24a. Also check the box on Form 1040, line 40b, or Form 1040A, line 24b			21	7,928

For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions. Cat. No. 49875F **Schedule L (Form 1040A or 1040) 2009**

Additional Standard Deduction Not Limited to One Vehicle

According to a press release issued by Thomson Reuters on May 11, 2009, a spokesperson from the IRS's National Media Relations office stated that the $49,500 purchase price limitation is imposed on a **per vehicle** basis. Consequently, a taxpayer can take the additional standard deduction on more than one vehicle purchased.[8]

> **Note.** Apparently, if the taxpayer purchases a new car for himself, his spouse, and each of his two children, he can deduct the sales tax on all four vehicles subject to the purchase price and phaseout limitation.

Special Break in States with No Sales Tax

The IRS announced that purchases of new motor vehicles in states without a sales tax can also qualify for the deduction.[9] Such states include Alaska, Delaware, Hawaii, Montana, New Hampshire, and Oregon. Taxpayers in these states are entitled to deduct other fees or taxes imposed by the state or local government which are based on the vehicle's sales price or as a per unit fee.

HIGHER AMT EXEMPTION AMOUNTS

The AMT exemption amounts for 2009 were increased to:

	Exemption Amount	
Filing Status	**2008**	**2009**
Married filing jointly or qualifying widow(er)	$69,950	$70,950
Single or head of household	46,200	46,700
Married filing separately	34,975	35,475

NONREFUNDABLE PERSONAL CREDITS

The ARRA extended for one year the provision allowing most nonrefundable personal credits against both regular tax and AMT liability to tax years beginning in 2009. These credits include the following:

- Child and dependent care credit
- Credit for the elderly and disabled
- Adoption credit
- Child tax credit
- Credit for interest on certain home mortgages
- Credit for higher-education expenses
- Saver's credit
- Credit for certain nonbusiness energy property
- Residential energy-efficient property credit
- Credit for plug-in electric drive motor vehicles
- D.C. first-time homebuyer credit

8. [thomsonreuters.com/content/press_room/tlr_taxacct/393581] Accessed on June 26, 2009.

9. IRS News Release IR-2009-60 (June 10, 2009).

11

DECREASED ESTIMATED TAX FOR QUALIFIED INDIVIDUALS

The estimated tax payments required of qualified individuals for tax years beginning in 2009 may be based on the lesser of:

- 90% of the tax shown on the tax return for the current tax year, or
- 90% of the tax shown on the preceding year's tax return (previously, the estimated tax requirement was 100% of the preceding year's tax liability).

A person is a qualified individual if:

1. The individual's AGI for the preceding tax year was less than $500,000 ($250,000 if married filing separately), and
2. The individual certifies that more than 50% of the gross income for the preceding year was from a small business (a trade or business with an average of less than 500 employees).

Note. The IRS is expected to issue regulations describing the form, manner, and time for the certification.

Example 29. Bruce and Zoe are wage earners with a substantial amount of dividends and interest. They do not have any income from a small business and consequently, they do not qualify for the 90% penalty exception.

QUALIFIED SMALL BUSINESS STOCK GAIN EXCLUSION

Old Law. Noncorporate taxpayers are allowed to exclude 50% of any gain from the sale of qualified small business stock held at least five years. Sixty percent of the gain on the sale of qualified small business stock under the empowerment-zone rules may be excluded. The taxpayer has to acquire the stock at original issue to be eligible for the exclusion. The limit on the gain from any single stock that a taxpayer may exclude is the greater of:

- Ten times the taxpayer's basis in the stock, or
- $10 million.

The corporation's gross assets cannot exceed $50 million when the stock is issued. In addition, at least 80% of its assets must be used in the active conduct of a qualified trade or business in order to qualify as a small business.

New Law. The gain exclusion for qualified small business stock is increased to 75% for stock acquired between February 17, 2009, and January 1, 2011. The increase in the gain exclusion does not apply to the sale of empowerment-zone stock.

Example 30. When her favorite quilt supply store closed for business, Debbie formed Quiltaholics, Inc., on May 5, 2009, and purchased the store's assets. Debbie has a basis in her stock of $40,000. The store became the flagship store of the quilting industry. Debbie sold her stock in 2015 for $1 million. Debbie's gain on the stock is $960,000. She is able to exclude $720,000 ($960,000 × 75%) from taxation under IRC §1202.

CANCELLATION OF INDEBTEDNESS DEFERRAL

Certain businesses can make an **irrevocable** election to have cancellation of debt income (CODI) generated from the reacquisition of certain debt instruments in 2009 and 2010 included in income over five tax years beginning in 2014. These debt instruments include bonds, debentures, notes, certificates, or any other instrument or contract of indebtedness.[10] The reacquisition must be made by the debtor that issued the debt instrument or a related person.

10. IRC §108(i)(3)(B).

If the taxpayer elects to defer the CODI, the taxpayer cannot use any of the other options of excluding debt discharge income, including:

- Discharge under Chapter 11 bankruptcy,
- Insolvent taxpayer rules,
- Qualified farm indebtedness, and
- Qualified real property business indebtedness.

The taxpayer must include an election statement with the tax return for the year the debt is reacquired which clearly identifies the debt instrument and the amount of income deferred.

Observation. This new provision allows certain businesses to recognize CODI on reacquired business debt over 10 years — by deferring tax on CODI for four to five years (from 2009 or 2010 to 2014) and recognizing the income over the following five taxable years.

IRC §179 EXPENSING ELECTION

The 2008 enhanced §179 expensing election was extended an additional year, to tax years **beginning** in 2009. The maximum §179 deduction is $250,000 per year with a dollar-for-dollar phaseout once qualifying property purchases exceed $800,000.

The Small Business and Work Opportunity Tax Act of 2007 set the limit at $125,000 plus an inflation adjustment for 2010. For 2011 and future years, the limit will return to $25,000 with no inflation adjustment. This assumes Congress makes no further changes to the §179 deduction.

Note. For more information about the §179 deduction, see Chapter 7 in the 2008 *University of Illinois Federal Tax Workbook.* This can be found on the accompanying CD.

50% BONUS DEPRECIATION

Fifty percent bonus depreciation is available for an additional year for qualifying property **placed in service** by December 31, 2009. The placed-in-service deadline for property with a longer production period, certain transportation property, and noncommercial aircraft is extended to December 31, 2010.

The $8,000 increase in first-year depreciation on passenger automobiles was also extended for one year. Qualifying vehicles must be placed in service by December 31, 2009. If the $8,000 increase is used in 2009, the luxury vehicle depreciation limits are:

	Limits			
Placed in Service	**2009**	**2010**	**2011**	**2012 and Later**
2009	$10,960	$4,800	$2,850	$1,775

Note. For more information about bonus depreciation, see Chapters 7 and 11 of the 2008 *University of Illinois Federal Tax Workbook.* They can be found on the accompanying CD.

S CORPORATION BUILT-IN GAINS TAX

A built-in gains (BIG) tax is imposed on assets sold by an S corporation that it held when it was converted from a C corporation, unless the assets are held for a statutorily-determined period of time.[11] This period is shortened from 10 years to 7 years for tax years beginning in 2009 and 2010. Consequently, a corporate-level tax will not be imposed on property held for more than seven years and sold in 2009 or 2010 by an S corporation which was converted from a C corporation.

Example 31. Alpha Corporation converted from a C corporation to an S corporation on January 1, 2002. If Alpha Corporation sells a lathe that was part of the C corporation property after January 1, 2009, no BIG tax is due because the 7-year holding period was satisfied.

Note. This change in the holding period does not apply to corporations converting from C to S status in 2009 and later years.

Additional discussion on the BIG tax is located in Chapter 10, C Corporation Issues.

2008 NOL CARRYBACK PERIOD INCREASED

Eligible small businesses (ESB) can elect a 3-, 4-, or 5-year carryback period for an NOL arising from a tax year beginning or ending in 2008. An affirmative election must be made to increase the carryback period from the 2-year period generally allowed.[12] Once the election is made, it is irrevocable. The 20-year carryforward period is unchanged.

An ESB for purposes of the increased carryback period is one whose 3-year average gross receipts ending with the tax year in which the loss arose does not exceed $15 million. When applying the average gross-receipts test, the receipts of all related entities must be included in the calculation.

If the business was not in existence for the entire 3-year period, the $15 million average is applied on the basis of the period during which the business was in existence. If a taxable year was less than 12 months, the gross receipts are annualized. The gross receipts for the short period are multiplied by 12 and then divided by the number of months in the short period.

Example 32. TherapyCo, Inc., is a calendar-year corporation that began business on June 1, 2006. The company's gross receipts are as follows:

Year	Gross Receipts	Annualized Gross
June 1 to December 31, 2006	$ 6,000,000	
Multiplied by 12/7 of a year	× 12/7	
	$10,285,714	$10,285,714
January 1 to December 31, 2007	20,000,000	20,000,000
January 1 to December 31, 2008	12,000,000	10,000,000
Total annualized gross receipts		$40,285,714
Divided by 3 years		÷ 3
Average annualized gross receipts		$13,428,571

Because TherapyCo's average annualized gross receipts are less than $15 million, it qualifies as an ESB.

11. IRC §1374.

12. IRC §172(b)(1)(H)(i).

The law states that the election is available for the tax year **ending in 2008,** unless the taxpayer elects this carryback for the tax year **beginning in 2008.** A calendar-year taxpayer can elect only for 2008. A fiscal-year taxpayer whose year ends in 2008 can make the election either for its fiscal year ending in 2008 or its fiscal year beginning in 2008 and ending in 2009, but not both.

To make the election, the taxpayer attaches a statement to the return stating that the taxpayer is electing to apply IRC §172(b)(1)(H), the length of the carryback period elected (three, four, or five years), and, if applicable, that the election is for the taxpayer's tax year that begins in 2008.

Example 33. HealthCo, Inc.'s fiscal year began on May 1, 2007, and ends on April 30, 2008. HealthCo is eligible for the extended NOL carryback period for the fiscal year ending on April 30, 2008.

Example 34. MedCo, Inc.'s fiscal year begins on February 1, 2008, and ends on January 31, 2009. MedCo is eligible for the extended NOL carryback period for the fiscal year ending January 31, 2009.

Note. The NOL calculations are discussed in more detail in Chapter 7, Net Operating Losses.

Election for Previously-Filed Return

If the 2008 return was already filed, the taxpayer may still make the election up to six months after the due date of the return, not including extensions. This is done by filing the appropriate form to apply the NOL carryback period chosen by the taxpayer as follows:

- **For corporations:** Form 1139, *Corporation Application for Tentative Refund*, or Form 1120X, *Amended U.S. Corporation Income Tax Return*
- **For individuals:** Form 1045, *Application for Tentative Refund*, or Form 1040X, *Amended U.S. Individual Income Tax Return*
- **For estates or trusts:** Form 1045 or amended Form 1041, *U.S. Income Tax Return for Estates and Trusts*

A taxpayer that makes the election by filing an amended return must file the return for the earliest taxable year to which the taxpayer is carrying back the applicable 2008 NOL. The taxpayer should not file an amended return for the applicable 2008 NOL taxable year.

Observation. A calendar-year corporation must have filed the amended return no later than September 15, 2009. However, fiscal-year corporations that elected to use the extended carryback period may still be able to file an amended return.

Partnerships, S Corporations, and Sole Proprietorships

If the taxpayer is a **partner in a partnership** that qualifies as an ESB, the taxpayer may make the carryback election under §172(b)(1)(H) for her distributive share of the qualifying ESB partnership income, gain, loss, and deduction that is both allocable to the taxpayer under IRC §704 and allowed in calculating the taxpayer's applicable 2008 NOL.

If the taxpayer is a **shareholder in an S corporation** that qualifies as an ESB, the taxpayer may make the carryback election under §172(b)(1)(H) for the pro-rata share of the qualifying S corporation income, gain, loss, and deduction under IRC §1366 that is allowed in calculating the shareholder's applicable 2008 NOL.

If the taxpayer is an **owner of a sole proprietorship** that qualifies as an ESB, the taxpayer may make the carryback election for the qualifying sole proprietorship income, gain, loss, and deduction that is allowed in calculating the taxpayer's applicable 2008 NOL.

In determining whether a partnership, S corporation, or sole proprietorship qualifies as an ESB, the gross-receipts test applies at the partnership, corporate, or sole proprietorship level. The aggregation rules of IRC §448(c)(2) apply to determine whether the partnership, S corporation, or sole proprietorship meets the gross-receipts test of §448(c). In applying this test under §448(c), "$15 million" is substituted for "$5 million."

The amount of the taxpayer's applicable 2008 NOL that the taxpayer may carry back is limited to the lesser of:

1. The taxpayer's items of income, gain, loss, or deduction that are allowed in calculating the taxpayer's applicable 2008 NOL and are from one or more partnerships, S corporations, or sole proprietorships that qualify as ESBs; or
2. The taxpayer's applicable 2008 NOL.

The preceding limitations serve to limit the increased carryback period to ESB items. The amount included in a taxpayer's applicable 2008 NOL (number 2 above) may include non-ESB losses, whereas only ESB income, loss, gains, and deductions are included in number 1. Thus, by limiting the carryback to the lesser of the two amounts, non-ESB amounts are excluded.

Example 35. Tyron is a partner in three partnerships — Alpha, Beta, and Kappa — that have average annual gross receipts of $10 million, $12 million, and $14 million, respectively. Tyron owns a 40% interest in each partnership. None of the partnerships is required to be aggregated with any other entity for purposes of the aggregation rules of §448(c)(2). Subject to the limitations listed above, Tyron may apply the carryback election under §172(b)(1)(H) to the portion of his applicable 2008 NOL attributable to his distributive share of the income, gain, loss, and deduction of each of the partnerships.

Example 36. The facts are the same as **Example 35,** except that the Alpha and Beta partnerships are under common control within the meaning of IRC §52(b)(1). Accordingly, Alpha and Beta are treated as one person under the aggregation rules of IRC §448(c)(2). Because the aggregated average annual gross receipts of Alpha and Beta exceed $15 million, Alpha and Beta do not qualify as ESBs. Tyron may not apply the election under §172(b)(1)(H) to the portion of his applicable 2008 NOL attributable to his distributive share of the income, gain, loss, and deduction of Alpha and Beta. However, subject to the limitations noted above, Tyron may apply the carryback election under §172(b)(1)(H) to the portion of his applicable 2008 NOL attributable to his distributive share of income, gain, loss, and deductions of Kappa.

WORK OPPORTUNITY TAX CREDIT EXPANDED

The work opportunity tax credit (WOTC) provides an incentive to hire an individual from a targeted group by allowing a tax credit of up to 40% of the first $6,000 of qualified wages paid to such individual during the first year of employment. The credit is reduced to 25% if the employee works 400 hours or less during the first year. No credit is allowed if the employee works less than 120 hours the first year. The list of targeted groups eligible for the credit was expanded to include **unemployed veterans** and **disconnected youth** who begin work for an employer in 2009 or 2010.

Unemployed veterans are defined as persons certified by the designated local agency as:

- Having served on active duty in the United States armed forces for more than 180 days, or having been released from active duty for a service-related disability;
- Having been discharged from active duty within the 5-year period preceding the date of hire; and
- Having received unemployment compensation for at least four weeks during the 1-year period preceding the date of hire.

Disconnected youth are defined as individuals who:

- Are between the ages of 16 and 25 on the hiring date;
- Have not regularly attended school for the six months preceding the hiring date;
- Have not been employed regularly for the six months preceding the hiring date; and
- Are not readily employable because of an insufficient number of basic skills.

Observation. Employees qualifying for the WOTC must be precertified by the local employment agency. However, the IRS gave relief to employers hiring WOTC-qualified employees after December 31, 2008, and before July 17, 2009, if they obtained the certification no later than August 17, 2009.[13]

Note. For more detailed information on the WOTC, see Chapter 6, Small Business Issues.

COBRA CONTINUATION RULES[14]

Old Law. Employers with 20 or more employees that maintain health insurance plans are obligated to offer continuation of health insurance benefits for a minimum of 18 months to eligible terminated employees. Terminated employees can continue coverage for themselves and their dependents by paying the full amount of health insurance premiums, plus up to 2% to cover administrative costs.

New Law. Eligible individuals can elect COBRA continuation coverage for health insurance by paying 35% of the premiums. A premium subsidy is provided for the remaining 65%. The subsidy is limited to no more than nine months per individual and is only provided to individuals subject to involuntary terminations on or after September 1, 2008, and before January 1, 2010. The subsidy applies to terminated employees and their family members who are qualified beneficiaries. The amount of the premium subsidy is excluded from gross income of eligible individuals.

In general, the provided COBRA coverage is the same coverage the individual had at the time of the involuntary termination. However, under the COBRA-subsidy provision, an employer may offer an assistance-eligible individual the option of choosing other coverage that is also offered to active employees and that does not have higher premiums than the coverage the individual had at the time of termination.

The subsidy is payable to:

1. The multi-employer group health plan,
2. The employer maintaining the group health plan, or
3. The insurer providing coverage.

These taxpayers are eligible to offset their payroll taxes for purposes of reimbursement. The credit is claimed on the employer's payroll tax return on Form 941, *Employer's QUARTERLY Federal Tax Return;* Form 944, *Employer's ANNUAL Federal Tax Return;* or Form 943, *Employer's ANNUAL Federal Tax Return for Agricultural Employees.*

Form 941 was modified to accommodate reporting of COBRA-premium-assistance payments. If the COBRA credit claimed on Form 941 is larger than the total payroll taxes for the period, there is an overpayment that can either be applied to the next return or requested as a refund.

13. IRS Notice 2009-28 IRB 2009-24 (June 15, 2009).

14. For more information, see IRS Notice 2009-27 IRB 2009-16 (Apr. 20, 2009). [www.irs.gov/pub/irs-drop/n-09-27.pdf] Accessed on July 15, 2009.

An employer can either offset its payroll tax deposits or claim the COBRA subsidy as an overpayment at the end of the quarter. The amount of the COBRA subsidy the employer provides during the quarter is treated as having been deposited on the first day of the quarter and applied against the employer's deposit requirements. Therefore, timely deposits up to the amount of the subsidy are deemed to have been made during the quarter, regardless of the otherwise applicable due dates for deposits. However, in some cases, the amount of the COBRA subsidy the employer provides during the quarter is less than the total amount of the employer's required deposits during the quarter. In that situation, the employer is required to make timely deposits during the remainder of the quarter to make up the difference.

Example 37. Epsilon Co. has required payroll tax deposits for the second quarter of 2009 which total $10,020. This is determined without regard to the COBRA-premium subsidy provided by Epsilon during the quarter. Epsilon provides assistance-eligible individuals with a total COBRA subsidy of $8,000 during the quarter and reports the $8,000 subsidy on line 12a of Form 941 (shown on the following page) for the quarter. Epsilon is treated as having made an $8,000 payroll tax deposit on the first day of the quarter. Consequently, it is not subject to a failure-to-deposit penalty for the quarter, provided that once the total of its required deposits exceeds $8,000, it makes its regularly-required deposits for the remainder of the quarter.

If a premium subsidy is provided to a taxpayer, the taxpayer's spouse, or the taxpayer's dependents during a taxable year, the amount of the premium subsidy must be repaid if the MAGI of the taxpayer exceeds $145,000 ($290,000 for MFJ). Repayment is made by an increase in the taxpayer's income tax liability for the taxable year equal to the amount of the subsidy. For taxpayers with MAGIs of $125,000 to $145,000 (or $250,000 to $290,000 for MFJ), the premium subsidy that must be repaid is reduced proportionately. Further instructions will be forthcoming from the IRS.

For Example 37

Form **941 for 2009: Employer's QUARTERLY Federal Tax Return** 950109
(Rev. January 2009) Department of the Treasury — Internal Revenue Service OMB No. 1545-0029

(EIN) Employer identification number	11 – 1111111
Name (not your trade name)	Epsilon Co.
Trade name (if any)	
Address (Number Street Suite or room number)	101 Main Street
City / State / ZIP code	Anytown / US / 00000

Report for this Quarter of 2009 (Check one.)

- [ ] 1: January, February, March
- [x] 2: April, May, June
- [ ] 3: July, August, September
- [ ] 4: October, November, December

Read the separate instructions before you complete Form 941. Type or print within the boxes.

Part 1: Answer these questions for this quarter.

		Column 1	Column 2	
1	Number of employees who received wages, tips, or other compensation for the pay period including: *Mar. 12* (Quarter 1), *June 12* (Quarter 2), *Sept. 12* (Quarter 3), *Dec. 12* (Quarter 4)			10
2	Wages, tips, and other compensation			30,000 .
3	Income tax withheld from wages, tips, and other compensation			4,971 .
4	If no wages, tips, and other compensation are subject to social security or Medicare tax			☐ Check and go to line 6.
5	Taxable social security and Medicare wages and tips:			
5a	Taxable social security wages	33,000 .	× .124 = 4,092 .	
5b	Taxable social security tips	.	× .124 = .	
5c	Taxable Medicare wages & tips	33,000 .	× .029 = 957 .	
5d	Total social security and Medicare taxes (*Column 2,* lines 5a + 5b + 5c = line 5d)			5,049 .
6	Total taxes before adjustments (lines 3 + 5d = line 6)			10,020 .
7	CURRENT QUARTER'S ADJUSTMENTS, for example, a fractions of cents adjustment. See the instructions.			
7a	Current quarter's fractions of cents		.	
7b	Current quarter's sick pay		.	
7c	Current quarter's adjustments for tips and group-term life insurance		.	
7d	TOTAL ADJUSTMENTS. Combine all amounts on lines 7a through 7c			.
8	Total taxes after adjustments. Combine lines 6 and 7d			10,020 .
9	Advance earned income credit (EIC) payments made to employees			.
10	Total taxes after adjustment for advance EIC (line 8 – line 9 = line 10)			10,020 .
11	Total deposits for this quarter, including overpayment applied from a prior quarter and overpayment applied from Form 941-X or Form 944-X		2,020 .	
12a	COBRA premium assistance payments (see instructions)		8,000 .	
12b	Number of individuals provided COBRA premium assistance reported on line 12a	6		
13	Add lines 11 and 12a			10,020 .
14	Balance due. If line 10 is more than line 13, write the difference here. For information on how to pay, see the instructions.			0 .
15	Overpayment. If line 13 is more than line 10, write the difference here		.	Check one ☐ Apply to next return. ☐ Send a refund.

▶ You **MUST** complete both pages of Form 941 and **SIGN** it. Next ➡

For Privacy Act and Paperwork Reduction Act Notice, see the back of the Payment Voucher. Cat. No. 17001Z Form **941** (Rev. 1-2009)

11

HEALTH COVERAGE TAX CREDIT

Old Law. IRC §35 allows a 65% refundable tax credit for the amounts that eligible individuals who are negatively impacted by trade acts spend on certain kinds of health coverage for themselves and family members. An example is an individual who lost her job because the employer moved production to a foreign country. Eligible individuals include:

- Trade Adjustment Assistance recipients,
- Alternative Trade Adjustment Assistance recipients, and
- Pension Benefit Guaranty Corporation recipients.

New Law. The health coverage tax credit (HCTC) increased from 65% to 80% of the premiums for qualified health insurance for eligible coverage months after April 30, 2009, and before January 1, 2011. One or more retroactive payments can be made under the advance-payment program for eligible coverage months beginning on or after January 1, 2009, and ending before January 1, 2011. The payments may be paid in advance directly to the healthcare provider.

Eligible individuals include persons who receive a trade readjustment allowance (TRA) for any day of the month and who receive unemployment compensation. Also eligible are individuals who would be otherwise eligible to receive TRA payments except for rules that require unemployment benefits to be exhausted and for the individual to be enrolled in a training program.

Individuals who receive COBRA premium assistance are not eligible for the HCTC for any month that COBRA assistance is provided.

ENERGY PROVISIONS

Residential Energy Credits

Residential energy credits include two different credits — the nonbusiness energy property credit and the residential energy efficient property credit. The **nonbusiness energy property credit** is only available for improvements made to the taxpayer's principal residence. However, the **residential energy efficient property credit** applies to any dwelling unit located in the United States and used as a residence by the taxpayer.[15]

> **Note.** Consumers can refer to Energy Star's website at **www.energystar.gov** for credit information. Click on the link "Tax Credits for Energy Efficiency."

Nonbusiness Energy Property Credit Modified. The nonbusiness energy property credit is available for energy-saving improvements made to a taxpayer's principal residence. A principal residence includes a house, houseboat, mobile home, cooperative apartment, condominium, or a manufactured home that conforms with the Federal Manufactured Home Construction and Safety Standards.

Qualified energy-efficiency improvements include items that comply with Energy Star requirements and are designed to reduce heat gain or loss, such as the following:

- Insulation material or system
- Exterior windows, including storm windows and skylights
- Exterior doors, including certain storm doors
- Certain metal or asphalt roofs with pigmented coatings or cooling granules

15. IRC §§25C and 25D.

The nonbusiness energy property credit was modified by the ARRA in the following ways:

- The allowable percentage of the amount paid for qualified energy-efficiency improvements has been raised from 10% to 30%.
- Energy property that was previously eligible for credits of a specific dollar amount (e.g., $50 for each advanced main air-circulating fan; $300 for qualified heat pumps, water heaters, and central air conditioners) is now eligible for a 30% credit.
- A cumulative credit of $1,500 for 2009 and 2010 replaces the previous $500 lifetime limit (of which only $200 could be applied for windows).
- The standards for products that qualify as energy efficient were raised.
- The credit is available for property placed in service from January 1, 2009, through December 31, 2010.

Note. If a taxpayer claimed the prior-law maximum $500 nonbusiness residential energy credit before 2009, the full $1,500 combined limit for 2009 and 2010 is allowable.

IRS Notice 2009-53 provides details on the nonbusiness energy property credit under IRC §25C. Section 6 of the notice offers guidance on the documentation that manufacturers of building envelope component or energy property must provide to taxpayers to certify that the property is **qualified** energy property. The certification statements can be included in the property packaging, made available in printable form on the manufacturer's website or in another form that will allow the taxpayer to retain the statement for tax recordkeeping purposes. However, for energy property purchased prior to June 1, 2009, taxpayers can rely on prior certification standards.[16]

The credit is claimed by completing Form 5695, *Residential Energy Credits*, and attaching it to Form 1040 or 1040NR.

Installation costs can be included in the cost eligible for the energy credit for the following items:

- HVAC (heating, ventilation, and air conditioning) systems
- Biomass stoves

Note. The term 'biomass' is defined in IRC §45K(c)(3) as any organic material other than oil, natural gas, coal, or any product thereof. The term thus includes corn, pellet, and wood-burning stoves. These stoves must have a thermal efficiency rating of at least 75% to qualify for the energy credit. For more information, see **www.energystar.gov.**

- Water heaters (including solar)
- Solar panels
- Geothermal heat pumps
- Wind energy systems
- Fuel cells

Installation costs for the following are **not eligible** for the credit:

- Windows
- Doors
- Insulation
- Roofs

16. IRS Notice 2009-53 IRB 2009-25 (June 22, 2009). [www.irs.gov/pub/irs-drop/n-09-53.pdf] Accessed on July 9, 2009.

Residential Energy Efficient Property Credit. The residential energy efficient annual credit limitations of $2,000 for solar hot water heaters, $2,000 for geothermal heat pumps, and $500 for each half kilowatt of electric wind-turbine capacity were eliminated for 2009 through 2016. The fuel cell plant annual credit limit of $500 for each half kilowatt of electric capacity continues.

Example 38. Chico and Carmen remodeled their principal residence in 2009. They paid $5,000 for energy-efficient windows and $2,000 for a new propane furnace. Both the windows and the furnace qualify for the residential energy credit. In addition, they purchased an eight kilowatt output proton exchange membrane (PEM) fuel cell power plant costing $25,000 for the home. Chico completes Form 5695 as shown on the following page:

Form **5695**

Department of the Treasury
Internal Revenue Service

Residential Energy Credits

▶ See instructions.
▶ Attach to Form 1040 or Form 1040NR.

OMB No. 1545-0074
2009
Attachment Sequence No. **158**

Name(s) shown on return	Your social security number
Chico and Carmen	**222-22-2222**

Before You Begin Part I: Figure the amount of any credit for the elderly or the disabled you are claiming.

Part I **Nonbusiness Energy Property Credit** (See instructions before completing this part.)

1	Were the qualified energy efficiency improvements or residential energy property costs for your main home located in the United States? (see instructions) ▶	1	☒ Yes ☐ No
	Caution: *If you checked the "No" box, you cannot claim the nonbusiness energy property credit. Do not complete Part I.*		
2	Qualified energy efficiency improvements (see instructions).		
a	Insulation material or systems specifically and primarily designed to reduce heat loss or gain in your home	2a	
b	Exterior windows including skylights	2b	5,000
c	Exterior doors	2c	
d	Metal or asphalt roof with appropriate pigmented coatings or cooling granules that meet the Energy Star program requirements and is specifically and primarily designed to reduce heat gain in your home	2d	
3	Residential energy property costs (see instructions).		
a	Energy-efficient building property	3a	
b	Qualified natural gas, propane, or oil furnace or hot water boiler	3b	2,000
c	Advanced main air circulating fan used in a natural gas, propane, or oil furnace	3c	
4	Add lines 2a through 3c	4	7,000
5	Multiply line 4 by 30% (.30)	5	2,100
6	Maximum credit amount. (If you jointly occupied the home, see instructions)	6	$1,500
7	Enter the smaller amount of line 5 or line 6	7	1,500
8	Enter the amount from Form 1040, line 46, or Form 1040NR, line 43 — **8** 16,000		
9	Enter the total, if any, of your credits from Form 1040, lines 47 through 50, and Schedule R, line 24; or Form 1040NR, lines 44 through 46 — **9** 0		
10	Subtract line 9 from line 8. If zero or less, **stop.** You cannot take the nonbusiness energy property credit	10	16,000
11	**Nonbusiness energy property credit.** Enter the smaller of line 7 or line 10	11	1,500

For Paperwork Reduction Act Notice, see instructions. Cat. No. 13540P Form **5695** (2009)

For Example 38

Form 5695 (2009) Page **2**

Before You Begin Part II:

Figure the amount of any of the following credits you are claiming.

- Credit for the elderly or the disabled.
- District of Columbia first-time homebuyer credit.
- Alternative motor vehicle credit.
- Qualified plug-in electric vehicle credit.
- Qualified plug-in electric drive motor vehicle credit.

Part II **Residential Energy Efficient Property Credit** (See instructions before completing this part.)

Note. *Skip lines 12 through 21 if you only have a* ***credit carryforward from 2008.***

12	Qualified solar electric property costs			12	
13	Qualified solar water heating property costs			13	
14	Qualified small wind energy property costs			14	
15	Qualified geothermal heat pump property costs			15	
16	Add lines 12 through 15			16	
17	Multiply line 16 by 30% (.30)			17	
18	Qualified fuel cell property costs	18	25,000		
19	Multiply line 18 by 30% (.30)	19	7,500		
20	Kilowatt capacity of property on line 18 above ▶ . 8 x $1,000	20	8,000		
21	Enter the smaller of line 19 or line 20			21	7,500
22	Credit carryforward from 2008. Enter the amount, if any, from your 2008 Form 5695, line 28			22	
23	Add lines 17, 21, and 22			23	7,500
24	Enter the amount from Form 1040, line 46, or Form 1040NR, line 43	24	16,000		
25	**1040 filers:** Enter the total, if any, of your credits from Form 1040, lines 47 through 50; line 11 of this form; line 12 of the Line 11 worksheet in Pub. 972 (see instructions); Form 8396, line 11; Form 8839, line 18; Form 8859, line 11; Form 8834, line 22; Form 8910, line 21; Form 8936, line 14; and Schedule R, line 24. **1040NR filers:** Enter the amount, if any, from Form 1040NR, lines 44 through 46; line 11 of this form; line 12 of the Line 11 worksheet in Pub. 972 (see instructions); Form 8396, line 11; Form 8839, line 18; Form 8859, line 11; Form 8834, line 22; Form 8910, line 21; and Form 8936, line 14.	25	1,500		
26	Subtract line 25 from line 24. If zero or less, enter -0- here and on line 27			26	14,500
27	**Residential energy efficient property credit.** Enter the smaller of line 23 or line 26			27	7,500
28	Credit carryforward to 2010. If line 27 is less than line 23, subtract line 27 from line 23	28			

Part III **Current Year Residential Energy Credits**

29	Add lines 11 and 27. Enter the result here and on Form 1040, line 52, or Form 1040NR, line 48, and check box c on that line	29	9,000

Form **5695** (2009)

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Small Wind-Energy Property Credit Cap Removed

The $4,000 annual limit on the energy credit for qualified small wind-energy property has been removed effective January 1, 2009. The 30% credit percentage is unchanged, however.

Plug-In Electric Vehicle Credit

Old Law. As part of the Energy Improvement and Extension Act of 2008, a tax credit is available for plug-in electric drive passenger vehicles and light trucks. The credit ranges from a minimum of $2,500 to a maximum of $7,500–$15,000 depending on kilowatt hours of battery capacity and gross-vehicle weight. The credit is available for vehicles placed in service in 2009 through 2014.

New Law. The credit for new qualified plug-in electric drive motor vehicles purchased **after** December 31, 2009 was modified. The maximum amount of the credit is $7,500, with a base amount of $2,500 and an additional $417 per kilowatt hour of battery capacity in excess of five kilowatt hours. Qualifying vehicles with at least four but less than five kilowatt hours of battery capacity are eligible for a $2,500 credit.

The following requirements apply to vehicles qualifying for this credit:

- The original use must begin with the taxpayer.
- It must be acquired by the taxpayer for use or lease and not for resale.
- It must be made by a manufacturer.
- It must have a gross-vehicle weight rating of less than 14,000 pounds.
- It must meet the standards of the Clean Air Act.
- It must be manufactured primarily for use on public streets, roads, and highways.
- It must be propelled to a significant extent by an electric motor that draws electricity from a rechargeable battery with a capacity of at least four kilowatt hours.

The new plug-in electric vehicle credit is claimed on Form 8936, *Qualified Plug-in Electric Drive Motor Vehicle Credit.*

The credit is phased out after 200,000 new qualified plug-in electric vehicles are sold by a manufacturer after December 31, 2009. This credit applies to units sold for use in the United States only.

Plug-In Vehicle Credit for Low-Speed Vehicles

A new credit was added for 2-wheeled, 3-wheeled, and low-speed plug-in electric vehicles. The credit is 10% of the purchase price with a maximum of $2,500.

The credit applies to vehicles purchased after February 17, 2009, through December 31, 2011.

Plug-In Electric Vehicle Conversion Credit

A credit has been added for the cost of converting an existing vehicle into a qualified plug-in electric vehicle. The amount of the credit is 10% of the conversion cost up to a maximum of $4,000. This credit is available for conversions after February 17, 2009, through December 31, 2011.

Qualified Alternative Fuel Vehicle Refueling Property Credit

The credit for installation of alternative fuel vehicle nonhydrogen-refueling property to be used in a trade or business is increased from 30% to 50%. The maximum amount of the credit is increased from $30,000 to $50,000 per location for property placed in service in 2009 and 2010.

The 30% credit percentage is unchanged for hydrogen-refueling property, but the maximum amount of the credit is increased to $200,000 for property placed in service in 2009 and 2010.

The credit for refueling property installed on property used as a principal residence was increased from 30% to 50%, with the maximum dollar amount increasing from $1,000 to $2,000 per tax year.

The credit can be claimed on Form 8911, *Alternative Fuel Vehicle Refueling Property Credit.* Taxpayers that are not partnerships, S corporations, or cooperatives and whose only source of this credit is from the aforementioned pass-through entities are not required to complete Form 8911. They can instead report the credit on Form 3800, *General Business Credit.*[17]

BUILD AMERICA BONDS

State and local governments can issue Build America bonds after February 17, 2009, and before January 1, 2011. These bonds may provide both taxable interest and a **federal tax credit** to the bondholder. The amount of the tax credit is 35% of the interest payable on the bond. To receive the tax credit, the bondholder must file Form 8912, *Credit to Holders of Tax Credit Bonds.*

A Build America bond is any obligation, other than a private activity bond, if all the following conditions apply:

- The interest on the obligations would be excludable from gross income under IRC §103 (refers to state and local bond interest).
- The obligation is issued before January 1, 2011.
- The issuer makes an irrevocable election to have IRC §54AA apply.[18]

Qualified Bonds

A qualified bond is any Build America bond that meets the following conditions:

1. The proceeds (less a reasonable reserve) are used for a qualified purpose, which includes the following:
    - Qualified forestry conservation
    - Clean renewable energy
    - Qualified energy conservation
    - Qualified zone academy
    - Qualified school construction
2. The issuer makes an irrevocable election to have IRC §54AA(g)(2)(B) apply.

In lieu of the bondholder's federal tax credit, state and local governments can elect to receive a **payment credit** for these qualified bonds. The IRS pays the issuer 35% of the interest payable under the bond on that date. To receive the payment credit, the entity must file Form 8038-CP, *Return for Credit Payments to Issuers of Qualified Bonds.*

17. See instructions to Form 8911.
18. IRC §54AA(d)(1).

CONSUMER ASSISTANCE TO RECYCLE AND SAVE PROGRAM

The Consumer Assistance to Recycle and Save Program (CARS) (also referred to as "Cash for Clunkers") is not a tax bill. The program contains one tax consequence which addresses whether the cash rebate is includable in taxable income.

The IRS treats the vouchers like other government aid and subsidy programs, such as:

- Certain farm conservation programs,
- Corporate capital improvement subsidies, and
- Nazi reparation payments.

The vouchers are tax free to the vehicle purchaser. The value of the vouchers are included in gross receipts for the car dealer.

The table on the following pages appeared in the Federal Register on Thursday, July 2, 2009, and shows the details of the program.

Summary Tables

Eligibility Requirements	
Trade-in Vehicle	• Is in drivable condition • Has been both continuously insured, consistent with the laws of your State, and continuously registered to the same owner for at least one year immediately prior to the trading-in of your vehicle under the CARS program • Manufactured less than 25 years before the date of trade in (i.e., before mid- to late-1984) and, in the case of category 3 trucks, not later than model year 2001 • Has a <u>combined</u> MPG of 18 or less (this does not apply to category 3 trucks, i.e., very large pickup trucks and cargo vans)
New Vehicle (Purchased or Leased)	• Is new (i.e., legal title has not been transferred to anyone) • Has manufacturer's suggested retail price of $45,000 or less

Incentive Amounts

If the type of new vehicle you want is a…	The combined MPG* of the new vehicle must be…	The type of vehicle you trade-in must be a…	Amount of incentive: If the difference in combined MPG between the new vehicle and trade-in vehicle is…	Amount of incentive: The incentive is…	
Passenger Automobile • <u>All passenger cars.</u>	At least 22 MPG	Passenger car, Category 1 or 2 truck	4-9 MPG	$3,500	
			10 MPG or more		$4,500
Category 1 Truck:† • <u>All SUVs</u> w/ GVWR <=10,000 lbs. • <u>Pickups</u> w/ GVWR <8,500 lbs. & wheelbase <= 115 in. • <u>Passenger vans & cargo vans</u> w/ GVWR <8,500 lbs. & wheelbase <= 124 in.	At least 18 MPG	Passenger car, Category 1 or 2 truck	2-5 MPG	$3,500	
			5 MPG or more		$4,500
Category 2 Truck:† • <u>Pickups</u> w/ GVWR <= 8,500 lbs. & wheelbase > 115 in. • <u>Passenger vans & cargo vans</u> w/ GVWR <= 8,500 lbs. & wheelbase > 124 in.	At least 15 MPG	Category 2 truck	1 MPG	$3,500	
			2 MPG or more		$4,500
		Category 3 truck	NA‡	$3,500	
Category 3 Truck:† • <u>Trucks</u> w/ GVWR 8,500-10,000 lbs. that are either pickup trucks with cargo beds 72" or longer or very large cargo vans.	NA‡	Category 3 truck	NA‡ However, the new vehicle must be similar in size or smaller than the trade-in	$3,500	

*MPG requirements are based on EPA's combined city/highway rating
†GVWR = Gross Vehicle Weight Rating
‡Not applicable; Category 3 trucks do not have EPA MPG ratings

Note. Although the "Cash for Clunkers" vouchers were expected to be used between July 1, 2009, and November 1, 2009, the government discontinued the program as of August 24, 2009 because the allocated funds ran out.

EXPIRING TAX PROVISIONS

The following table lists selected tax provisions scheduled to expire in 2009–2011. The entire list can be found on the Joint Committee of Taxation's website at **www.jct.gov/x-20-09.pdf.** At the time this table was prepared, these provisions were not extended beyond the dates shown.

IRC Section	Expiring Provision	Expiration Date
Alternative Minimum Tax		
55(d)(1)	Increased AMT exemption amount	Dec. 31, 2009
57(a)(5)(C)(vi) 56(g)(4)(B)(iv)	Modification of AMT limitations on tax-exempt bonds	Dec. 31, 2010
Amortization, Depletion, and Depreciation		
168(e)(3)(B)(vii)	5-year depreciation for farming business machinery and equipment	Dec. 31, 2009
168(e)(3)(E)(iv), (v), and (ix)	15-year SL cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements	Dec. 31, 2009
168(i)(15)	Accelerated depreciation for business property on an Indian reservation	Dec. 31, 2009
168(k)(2)	Additional first-year depreciation for 50% of basis of qualified property	Dec. 31, 2009
168(k)(4))	Election to accelerate AMT and research credits in lieu of additional first-year depreciation	Dec. 31, 2009
179(b)(7)	Increase in expensing to $250,000/$800,000	Dec. 31, 2009
179E	Election to expense advanced mine-safety equipment	Dec. 31, 2009
613A(c)(6)(H)	Suspension of 100% of net income limitation on percentage depletion for oil and gas from marginal wells	Dec. 31, 2009
167(g)(8)	5-year amortization of music and music copyrights	Dec. 31, 2010
179(b)(1) and (2), (c)(2), and (d)(1)(A)(ii)	Increase in expensing to $125,000/$500,000 (indexed)	Dec. 31, 2010
198A	Expensing of qualified disaster expenses	Dec. 31, 2009
168(n)	Special depreciation allowance for qualified disaster property	Dec. 31, 2009
179(e)	Increased expensing for qualified disaster-assistance property	Dec. 31, 2009
15345 of P.L. 11-246	Tax relief for Kiowa County, Kansas, and surrounding area by reason of severe storms and tornados beginning May 4, 2007 Additional depreciation allowance for nonresidential real property and residential rental property Expensing for demolition and clean-up costs Net operating losses	Dec. 31, 2009

IRC Section	Expiring Provision	Expiration Date
Credits		
26(a)(2)	Personal credits allowed against regular tax and AMT	Dec. 31, 2009
30B(k)(3)	First-time homebuyer credit	Nov. 30, 2009
40A(g)	Income tax credits for biodiesel fuel, biodiesel used to produce a qualified mixture, and small agri-biodiesel producers	Dec. 31, 2009
6426(c)(6) 6427(e)(5)(B)	Income tax credits for renewable diesel fuel and renewable diesel used to produce a qualified mixture	Dec. 31, 2009
6426(c)(6) 6427(e)(5)(B)	Excise tax credits and outlay payments for biodiesel fuel mixtures	Dec. 31, 2009
6426(c)(6) 6427(e)(5)(B)	Excise tax credits and outlay payments for renewable diesel fuel mixtures	Dec. 31, 2009
41(h)(1)(B)	Tax credit for research and experimentation expenses	Dec. 31, 2009
45A(f)	Indian employment tax credit	Dec. 31, 2009
45D(f)(1)	New markets tax credit	Dec. 31, 2009
45L(g)	Credit for construction of new energy-efficient homes	Dec. 31, 2009
45N	Mine-rescue team training credit	Dec. 31, 2009
45P	Employer wage credit for activated military reservists	Dec. 31, 2009
Sec. 2202 of P.L. 111-5	Refundable credit for government retirees	Dec. 31, 2009
24(d)	Refundable child credit floor amount	Dec. 31, 2010
25A(i)	American opportunity tax credit (expanded Hope credit)	Dec. 31, 2010
25C(g)	Credit for certain nonbusiness energy property	Dec. 31, 2010
32(b)(3)(A)	EIC credit percentage of 45% for three or more qualifying children	Dec. 31, 2010
32(b)(3)(B)	EIC phaseout threshold for marriage-penalty relief	Dec. 31, 2010
35(a)	Enhanced credit for health insurance costs of eligible individuals	Dec. 31, 2010
36A	Making work pay credit	Dec. 31, 2010
45M(b)	Credit for energy-efficient appliances	Dec. 31, 2010
51(c)(4)	Work opportunity tax credit	Aug. 31, 2011
48(d)	Grants for specified energy property in lieu of tax credits	Dec. 31, 2010
48(a)(5)	Election of investment credit in lieu of production tax credit	Dec. 31, 2010
30(f)	Credit for electric-drive motorcycles, 3-wheeled vehicles, and low-speed vehicles	Dec. 31, 2011
30B(i)(4)	Conversion credit for plug-in electric vehicles	Dec. 31, 2011
142(d)	Treatment of military basic housing allowances under low-income housing credit	Dec. 31, 2011
51(d)(14)	Work opportunity tax credit targeted group status for unemployed veterans and disconnected youth	Dec. 31, 2010

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IRC Section	Expiring Provision	Expiration Date
Charitable Contributions		
170(b)(1)(E) 170(b)(2)(B)	Encouragement of contributions of capital gain real property made for conservation purposes	Dec. 31, 2009
170(e)(3)(C)	Enhanced charitable deduction for contributions of food inventory	Dec. 31, 2009
170(e)(3)(D)	Enhanced charitable deduction for contributions of book inventories to public schools	Dec. 31, 2009
170(e)(6)(G)	Enhanced deduction for corporate contributions of computer equipment for educational purposes	Dec. 31, 2009
1367(a)	Basis adjustment to stock of S corporations making charitable contributions of property	Dec. 31, 2009
Deductions		
3082 of P.L. 110-289	Period to amend returns to reduce casualty losses later compensated by federal-relief grants, and limited relief from interest and penalties	July 30, 2009
54M	Issuance of clean renewable energy bonds (CREBs)	Dec. 31, 2009
62(a)(2)(D)	Deduction for certain expenses of elementary and secondary school teachers	Dec. 31, 2009
63(c)(7)	Additional standard deduction for state and local real estate taxes	Dec. 31, 2009
85(c)	Exclusion of unemployment compensation benefits from gross income	Dec. 31, 2009
164(b)(5)	Deduction of state and local general sales taxes	Dec. 31, 2009
164(b)(6)(G)	Deduction for state sales tax and excise tax on the purchase of motor vehicles	Dec. 31, 2009
222(e)	Above-the-line deduction for qualified tuition and related expenses	Dec. 31, 2009
132(f)	Parity for exclusion for employer-provided mass transit and parking benefits	Dec. 31, 2010
163(h)(3)	Premiums for mortgage insurance deductible as interest that is qualified residence interest	Dec. 31, 2010
529(e)(3)(A)(iii)	Computer technology and equipment allowed as a qualified higher-education expense for §529 accounts	Dec. 31, 2010
165(h)	Losses attributable to federally-declared disasters	Dec. 31, 2009
172(b)(1)(J)	NOLs attributable to federally-declared disasters	Dec. 31, 2009
Income		
856(c)(2)(I) 856(c)(8))	Mineral royalties treated as qualified REIT income for timber REITs	May 23, 2009
857(b)(6)(G) and (H), and former sec. 857(b)(6)(D)	Sales by REITs of timber property held at least two years to qualified organizations for conservation purposes treated as sale of property held for investment or used in a trade or business	May 23, 2009
108(i)	Deferral and ratable inclusion of income from business debt discharged by reacquisition	Dec. 31, 2010
139B	Exclusion from income for benefits provided to volunteer firefighters and emergency medical responders	Dec. 31, 2010
1202(a)(3)	Special rules for qualified small business stock	Dec. 31, 2010

IRC Section	Expiring Provision	Expiration Date
Rates		
1201(b)	Temporary reduction in corporate rate for qualified timber gain	May 23, 2009
3301(1)	FUTA surtax of 0.2%	Dec. 31, 2009
Sec. 6432 and sec. 3001 of P.L. 111-5	65% subsidy for payment of COBRA health care coverage continuation premiums	Dec. 31, 2009
6654(d)(1)(D)	Reduced estimated tax payments for small businesses	Dec. 31, 2009
1(h) 1445(e)(6)	Reduced capital gain rates	Dec. 31, 2010
1(h)	Dividends taxed at capital gain rates	Dec. 31, 2010
1374(d)(7)	Reduction in S corporation recognition period for built-in gains tax	Dec. 31, 2010
Retirement		
219(b)(5)(C)	Allowance of additional IRA contributions in certain bankruptcy cases	Dec. 31, 2009
401(a)(9)(H)	Waiver of RMD rules for IRAs and defined-contribution plans	Dec. 31, 2009
408(d)(8)	Tax-free distributions from individual retirement plans for charitable purposes	Dec. 31, 2009