Starting in 2009

Tax Credit of Up to $8,000 for First-Time Homebuyers and $6,500 for Existing Homeowners

The Congress and the Obama Administration have extended and expanded the wildly popular 2008 first-time homebuyer tax credit. Now, existing homebuyers are eligible to receive a tax credit of up to $6,500 if they buy a replacement home by June 30, 2010. In addition, the income limits have been increased, making even more people eligible for these credits.

If you purchased a primary residence in 2009 before December 1, 2009, and are a “first-time” homebuyer, you can qualify for a tax credit equal to 10 percent of up to $80,000 of the purchase price. To be eligible, you must not have owned a residence in the United States in the previous three years.

The credit is refundable to the extent it exceeds your regular tax liability, which means that if it more than offsets your tax liability, you’ll get a refund check. But it does not offset the Alternative Minimum Tax.

You can even elect to claim the credit for a 2009 home purchase on your 2008 tax return. (If you filed for 2008 before buying, but before the December 1, 2009, deadline, you can claim your credit by filing an amended return using Form 1040X. Doing so will guarantee you a refund check.) The credit for 2009 purchases generally doesn’t have to be paid back. But you will have to repay it if you sell the house within three years of the date you bought it.

In November 2009, the program was broadened to include existing homeowners, meaning those who have lived in the same principal residence for any five-consecutive-year period during the past eight years. Homeowners are eligible for a credit of up to $6,500 if they buy a replacement home to use as their principal residence. They are not required to sell or dispose of their current home, but the new home must become their principal residence. To be eligible, homebuyers must buy, or enter into a binding contract to buy, a replacement principal residence after Nov. 6, 2009, and on or before April 30, 2010, and close on the home by June 30, 2010.

In addition, income limits were expanded from earlier versions of the credit. Homebuyers who file as single or head-of-household taxpayers can claim the full credit if their modified adjusted gross income (MAGI) is less than $125,000. For married couples filing a joint return, the combined income limit is $225,000.

Single or head-of-household taxpayers who earn between $125,000 and $145,000, and married couples who earn between $225,000 and $245,000 are eligible to receive a partial credit. The credit is not available for single taxpayers whose MAGI is greater than $145,000 and married couples with a MAGI over $245,000. Also, homes costing more than $800,000 are not eligible for the credit.

Payroll Tax Credit

For 2009 and 2010, Congress gave workers a credit of 6.2 percent of their earned income, capped at $400 for single filers and $800 for joint filers. For single filers, the credit starts phasing out at $75,000 of Adjusted Gross Income and dries up at $95,000. The phase-out zone for couples is $150,000-$190,000. Employees will get the credit in advance via lower income tax withholding in each paycheck, not as a rebate check.

Self-employed taxpayers can reduce their quarterly estimated payments to get an advance benefit from the credit. The exact amount of the payroll tax credit for the year will be calculated on the filers' tax returns. Recipients of Social Security benefits, Railroad Retirement benefits, Supplemental Security Income or veteran disability pensions get a one-time $250 check for 2009. Federal retirees who don't receive Social Security payments also get a $250 check.

Sales Tax Deduction for New Vehicles

Buyers of new vehicles can deduct the sales tax paid on the purchase, even if they don't claim sales taxes as itemized deductions. They can add the tax they pay to their standard deduction. This break applies to new cars, motor homes, light trucks and motorcycles purchased after February 16, 2009 and before January 1, 2010. Sales tax paid on the first $49,500 of cost qualifies. The benefit begins phasing out for married couples with AGI over $250,000 and singles with Adjusted Gross Income over $125,000. It is completely gone for single filers with Adjusted Gross Income of $135,000 or more, or joint filers with AGI of at least $260,000.

Itemizers who elect to deduct state sales taxes in lieu of state income taxes get no benefit from this change, since the auto sales tax is already included in the sales tax deduction. Itemizers who deduct state income taxes will get a separate deduction for auto sales taxes; non-itemizers will add the sales tax amount to their standard deduction amount.

Indexed Tax Brackets

Thanks at least in part to the increase in federal spending and the federal budget deficit in the past few years, the 10 percent, 15 percent, 25 percent, 28 percent, 33 percent and 35 percent tax brackets all kick in at more than 4 percent higher levels of income than in 2008.

Personal Exemptions

For 2009, each personal exemption you can claim is worth $3,650, the same as in 2008.

Higher Standard Deductions

For 2009, the standard deduction for married taxpayers filing a joint return is $11,400, up by $450 from 2008. Joint filers can also add in up to $1,000 of property taxes paid.

For single filers, the amount is $5,700 in 2009, up by $250 over 2008. Singles can also deduct up to $500 of real estate tax payments.

Heads of household can claim $8,350 in 2009, a jump of $350 from 2008.

Non-itemizers who pay real estate taxes can claim even larger standard deductions. Non-itemizers can also add any casualty losses that occurred in presidentially-declared disaster areas.

Reduction in Itemized Deductions and Personal Exemptions for High-Income Taxpayers

Itemized deductions and personal exemptions are phased out as your income rises. In 2009, the reductions are a bit less painful than they were in 2008. The cutback in itemized deductions occurs once your Adjusted Gross Income exceeds $166,800, regardless of your filing status. Your itemized deductions are reduced by 1 percent of the amount by which your AGI exceeds $166,800, but you can never lose more than 80 percent of your itemized deductions. Also, your medical expenses, investment interest deduction, deductible gambling losses and any casualty and theft losses are not subject to the cut. Personal exemptions are reduced by 2 percent for each $2,500 of Adjusted Gross Income over $250,200 for married filing jointly, $208,500 for heads of households and $166,800 for singles, but the reduction cannot exceed $1,217 per exemption.

Section 179 Expense Deduction

The maximum amount of equipment placed in service in 2009 that businesses can expense stays at $250,000. And the annual investment limit remains $800,000. Thus, you won't begin to lose the benefit of expensing until you place more than $800,000 of assets in service in 2009. However, you need to act quickly because the allowance drops to $135,000 for tax years beginning in 2010.

Tax-Free Parking for Employees

Starting in 2009, firms can pay for $230 a month of parking tax-free for employees, up $10 per month from 2008. The cap on tax-free transit passes is now $230 a month as well, the same as for parking. The limit had been $115 a month in 2008.

Tax Credit for College Tuition

For 2009 and 2010, the Hope credit is replaced by a new credit of up to $2,500 per student per year for four years of college. It now also covers the cost of books, and begins to phase out at $80,000 of Adjusted Gross Income for single filers and $160,000 for joint filers. If the credit is more than your income tax liability, 40 percent of it is refundable. Also, the full credit is allowed against the Alternative Minimum Tax.

Educators' Deduction

Educators may deduct up to $250 of classroom supplies that they purchased with their own funds. This deduction is scheduled to end after 2009.

Child Tax Credit

If the credit exceeds the filer’s tax liability, all or part of the credit will be refunded if the filer earns more than $3,000 in 2009 and 2010, down from $12,550 in earnings previously.

Earned Income Tax Credit (EITC)

For families with three or more children, the maximum Earned Income Tax Credit for 2009 and 2010 rises by $628.50. And the phaseout of the credit for joint filers starts at higher income levels in 2009 and 2010, allowing more of them to claim the credit.

Nontaxable Combat Pay Allowed for Earned Income Tax Credit (EITC)

The election to include nontaxable combat pay in the calculation of earned income for the Earned Income Tax Credit applies for 2009.

Kiddie Tax

In 2009, a child's unearned income over $1,900, such as gains and dividends, is taxed at the parents' marginal rate until the year the child is age 19, or age 24 for full-time students whose earned income is less than half their support.

Direct Donations of IRAs to Charity

Unless Congress acts to extend it, 2009 is the last year that IRA owners age 70 ½ and older can donate up to $100,000 of their IRAs to charity without having to report the withdrawal as income and deduct the donation as a charitable contribution. Deductions will not be limited by the Adjusted Gross Income cap on charitable contributions or the itemized deduction phaseout. Keeping IRA distributions out of adjustable gross income in the first place can also have other benefits. Amounts donated in this way count as all or part the IRA owner’s required minimum distribution.

Higher Income Limits for Deductible IRAs and for Roth IRAs

If you are covered by a retirement plan at work, you can take a full IRA deduction in 2009 if your modified Adjusted Gross Income is less than $89,000 (married filing jointly) or $55,000 (single or head of household). A partial deduction is allowed until your Adjusted Gross Income reaches $109,000 if you are married filing jointly, or $75,000 if you are single or a head of household. Also, the opportunity to contribute to a Roth IRA is now phased out as your modified Adjusted Gross Income rises between $166,000 and $176,000 if you are married filing jointly, or $105,000 to $120,000 if you are single or a head of household.

Contribution Limit for 401(k) Plans

The maximum employee contribution rises to $16,500 in 2009 from $15,500 for 401(k) and similar workplace retirement plans, including 403(b)s and the federal Thrift Savings Plan. Workers age 50 and older in 2009 can put in an additional $5,500, making their maximum $22,000. These limits remain the same in 2010.

Capital Gains Tax Rates

The tax rate on capital gains from the sale of assets held longer than one year remains at 0% for people in the 10 percent or 15 percent tax brackets. The 15 percent maximum tax rate on long-term capital gains for taxpayers in higher brackets also remains the same. Rates are scheduled to increase in 2011.

Dividend Tax Rates

Similarly, the special 5 percent maximum rate on dividends of taxpayers in the 10 percent and 15 percent tax brackets remains at zero percent through 2010. Rates are scheduled to increase in 2011.

Estate Tax Exemption

For 2009, the federal estate tax exemption is $3,500,000.

Higher Annual Gift Tax Exemption

For 2009, you can give up any individual up to $13,000 without owing any gift tax.

Exemptions for the Alternative Minimum Tax (AMT)

For 2009, the exemption levels rise to $70,950 for married couples filing jointly, $46,700 for singles and heads of household, and $35,475 for married couples filing separately. Otherwise, about 28 million filers would have been added to the AMT rolls. Congress is likely to act again to prevent this from happening for the 2010 tax year. Also, interest on private-activity bonds issued in 2009 and 2010 is exempt from the Alternative Minimum Tax.

Income Earned Abroad

The maximum foreign earned income exclusion is increased to $91,400, up from $87,600 in 2008.

Credit for Residential Energy-Efficient Property

The credit for 30 percent of the cost of installing solar water heating equipment, solar electric equipment, geothermal heat pumps or small wind turbines in your primary residence or a second home is unlimited in 2009. But the credit for fuel cell property cannot exceed $500 per half-kilowatt capacity.

Credit for Energy-Saving Home Improvements

The tax credit for the cost of energy-saving home improvements is 30 percent for 2009 and 2010, up to a maximum of $1,500 in the two-year period. It applies to qualified skylights, windows, outside doors, biomass fuel stoves and high-efficiency furnaces, water heaters and central air conditioners.

Converting a Second Home to a Primary Home

If you convert a second home into a principal residence after 2008, you may not be able to exclude all of your gain. A portion of the gain on a subsequent sale of the home will be ineligible for the home-sale exclusion of up to $500,000, even if the seller meets the two-year ownership-and-use tests. The portion of the profit that’s subject to tax is based on the ratio of the time after 2008 when the house was a second home or a rental unit, to the total time you owned it. So if you have owned a vacation home for 18 years and make it your main residence in 2011 for two years before selling it, only 10 percent of the gain (two years of nonqualified second home use divided by 20 years of total ownership) is taxed. The rest qualifies for the home-sale exclusion of up to $500,000.

Refundable Child Tax Credit

The $8,500 income threshold needed to qualify to claim the child tax credit if it exceeds your regular income tax bill decreases to $3,000 for 2009.

Partial Exclusion for Unemployment Benefits

For 2009, the first $2,400 of unemployment benefits you receive is tax-free. However, this benefit is scheduled to end in 2010.

College Savings Plans

Beginning in 2009, 529 College Savings Plans can be tapped tax-free to pay for a computer or Internet access.

Estimated Tax Relief for Owners of Small Businesses

If an individual's Adjusted Gross Income for 2008 was less than $500,000 and more than half of the gross income was from a business with fewer than 500 workers, the estimated income taxes for 2009 estimated tax payments can be based on the lesser of 90 percent of tax liability for 2008 or 2009. The usual estimated tax benchmarks of 100 percent or 110 percent of tax liability do not apply.