Godfrey Hammel, Danneels & Company, P.C.
Certified Public Accountants & Business Consultants

21420 Greater Mack Avenue, St. Clair Shores, Michigan 48080 • 586.772.8100 • Fax: 586.772.6715 • www.ghd.com

Spring 2009

IN THIS ISSUE:

INDIVIDUALS
Enhanced First-time Homebuyer Credit
New Car Sales Tax Break
Modified Hope Credit for Higher Education Costs
Energy Credits for Principal Residence

BUSINESSES
COBRA Health Insurance Continuation
Business Energy Credits
Improved Jobs Tax Credits

INDIVIDUALS

Enhanced First-time Homebuyer Credit

In the American Recovery and Reinvestment Act of 2009 ("the 2009 Act"), Congress expanded the first-time homebuyer credit that was enacted in 2008 to further stimulate the housing market. Originally, qualifying taxpayers who purchased a principal residence on or after April 9, 2008, and before July 1, 2009, were entitled to a maximum $7,500 tax credit on their 2008 tax returns. Because that credit was required to be paid back over a 15-year period through subsequent year tax return payments, the 2008 credit was really an interest-free loan.

The 2009 Act enhances the credit in several significant ways. Taxpayers now have until November 30, 2009, to purchase their first home. The maximum credit is increased to $8,000 and is now a true tax credit that need not be paid back. (These enhancements are applicable only to homes purchased in 2009.) The credit continues to be refundable; it will be allowed in full even if it reduces the taxpayer's tax liability below zero. And for those who purchase in 2009, the credit can electively be placed in the 2008 tax return to recover the refund earlier.

The maximum amount of the credit is calculated as 10% of the purchase price, up to $8,000 for married taxpayers or $4,000 for married taxpayers filing separately. The credit phases-out for taxpayers whose modified adjusted gross income (AGI) is more than $75,000 (single) or $150,000 (married). The credit is recaptured if the home is sold or is no longer used as the taxpayer's principal residence within three years of purchase.

A “first-time homebuyer” is any individual who has not owned a principal residence for three years before the purchase. In the case of a married couple, no credit is allowed if *either* is ineligible. Generally, any purchase qualifies for the credit unless from a related person.

Special rules apply for single co-owners. If two or more unmarried taxpayers purchase a principal residence together, the credit may be allocated between them using any reasonable method, but may not be allocated to an ineligible taxpayer. The allocation may be based on the amounts they contributed to purchase the home or their ownership interests in the residence.

Example: Assume that A and B each purchase a 50% interest in a home that costs $60,000. A contributes $45,000 and B contributes $15,000 towards the cost. The allowable credit will be $6,000 (10% of the purchase price), which may be allocated 75% to A and 25% to B based on their payments, or 50% to each based on their ownership interests. Alternatively, the credit may be allocated entirely to A or B because both are eligible to claim the entire credit. However, if B previously owned a home within the three-year period, B may not claim the credit, but the entire $6,000 credit may be allocated to A. But if A and B had married before purchasing the home, and B had previously owned a home within the three-year period, no credit may be claimed. Thus, the law currently favors single taxpayers.

New Car Sales Tax Break

The 2009 Act also contains a provision to stimulate the automobile industry. Taxpayers who buy a new passenger vehicle (*e.g.*, new cars, light trucks, motor homes, and motorcycles) in the United States after February 16, 2009, and before January 1, 2010, may be entitled to deduct in 2009 any state and local sales and excise taxes paid on the first $49,500 of cost. This deduction is added to other itemized deductions, but taxpayers that do not itemize add it to the standard deduction. This new deduction will also be allowed for purposes of the Alternative Minimum Tax (AMT). But the deduction is phased-out for taxpayers whose AGI is between $125,000 and $135,000 (single) and between $250,000 and $260,000 (married).

Observation: The law is not clear as to whether taxpayers may claim this deduction with respect to one qualified vehicle purchase only. Potentially, a husband and wife could each purchase a new car and claim the sales tax deduction on their joint 2009 tax return up to the $49,500 purchase price limitation for each vehicle. Presumably, future IRS guidance will clarify this issue.

Modified Hope Credit for Higher Education Costs

Because of recent enhancements to the Hope Credit in 2009, more taxpayers will be able to utilize this credit for qualifying post-secondary educational expenses.

Background. Before the 2009 Act, individual taxpayers were allowed a non-refundable credit against their income tax for either the Hope Credit or the Lifetime Learning Credit for higher education tuition. For 2009, the Hope Credit was $1,800 per student (*i.e.,* the taxpayer, a spouse, or dependent) for tuition and fees paid for the first two years of the student's post-secondary education. The Lifetime Learning Credit, which has a maximum of $2,000, was allowed for an unlimited number of years. But both credits phased-out ratably for taxpayers with modified AGI of between $50,000 and $60,000 (single) and $100,000 and $120,000 (married). This income phase-out made the credits unavailable to many taxpayers.

The New Law. The 2009 Act modifies the Hope Credit (now called the "American Opportunity Tax Credit") and makes the following changes for tax years 2009 and 2010:

- The modified AGI phaseout range is increased to $80,000 to $90,000 (single) and $160,000 to $180,000 (married);
- The maximum credit is increased to $2,500 per eligible student per year for qualified expenses;
- Qualified expenses include course materials (books) in addition to tuition and fees;
- The credit is now allowable for the first four years of the student's post-secondary education (two additional years);
- 40% of the credit is generally refundable.

Example: For 2009, H and W (married joint filers) are eligible for the enhanced $2,500 Hope credit. They have modified AGI of less than $160,000 so the phase-out rules do not apply. However, other credits are applied first to offset their tax liability for the year, reducing that liability to zero. Under the 2009 Act, 40% of the $2,500 credit ($1,000) may be claimed by H and W as a refund. The remaining $1,500 of the credit is lost.

There is no change to the Lifetime Learning Credit ($2,000 maximum credit per return). Tuition and fees are eligible for the enhanced Hope Credit or the Lifetime Learning Credit, but not both for the same student in the same tax year. Because the Lifetime Learning Credit has a lower income range, and now produces a smaller top credit, it will only apply where the student is past the first four years of post-secondary education.

Energy Credits for Principal Residence

In the Fall 2008 newsletter, we mentioned that the Residential Energy Credit was taken out of the law for 2008. Previously, taxpayers could claim a maximum $500 lifetime credit for energy-efficient improvements installed in their principal residence. The credit was 10% of the amount paid for improvements such as windows, doors, and insulation, plus a fixed credit ranging from $50 to $300 for energy-efficient fans, furnaces, boilers, heat pumps, water heaters, central air conditioners, and biomass fuel stoves.

The good news is that the 2009 Act has restored and significantly enhanced the credit for energy efficient home improvements for 2009 and 2010. The credit is now 30% of qualified

expenditures, and the former $500 lifetime cap is replaced with a new $1,500 aggregate limitation for 2009 and 2010. In addition, the following changes were made:

- The former dollar caps of $50 to $300 for some improvements have been eliminated, and the 30% credit is now available for all eligible energy property;
- New efficiency standards apply after February 17, 2009, to most property qualifying for the credit.

This restored energy credit has another key feature: All taxpayers can use it. There is no phase-out for higher income filers.

Finally, an enhancement was made to a second Residential Energy Credit that applies to high-tech improvements such as solar panels, geothermal heat pumps, and wind turbines. A 30% tax credit has applied to these items in the past, but the credit was subject to a limit ranging from $2,000 to $4,000. But effective in 2009, the dollar caps are gone. The credit is a straight 30% of the cost of the improvement.

Please let us know if we can assist with eligibility questions for any of these enhanced tax credits.

BUSINESSES

COBRA Health Insurance Continuation

Since 1985, COBRA has required businesses with 20 or more employees to permit their terminated employees (and their spouses and dependents) to participate in the employer's health insurance plan, typically for 18 months. The employer may charge former employees up to 102% of the premium if they continue their insurance coverage.

Although COBRA provides a benefit to persons who might not otherwise have access to health insurance, that benefit frequently comes with a significantly increased cost to the former employee. This can be particularly harsh during times when unemployment is high and severance payments are low. Individuals who require COBRA coverage may not be able to afford the increased expense to maintain that health coverage.

Congress addressed this problem in the 2009 Act by making it less expensive for recently terminated employees to retain their health insurance. The new law provides a 65% government subsidy of the COBRA premiums for up to a nine-month period. In general, the former employee pays 35% of the COBRA premiums and the employer pays the balance, but is later reimbursed through payroll tax credits.

Organizations with 20 or more employees are required to comply with this new law, including paying the insurance premiums in advance. Organizations with less than 20 employees are typically exempt from COBRA. However, there is a provision in the new law that requires small employers to offer the subsidy if state law requires them to provide health continuation coverage comparable to that required under the COBRA rules. An employer with a state-mandated plan receives the 35% premium payment from a former employee; however, the insurer is to make the remaining 65% payment (*i.e.*, it will bill the employer only 35%). The 65% subsidy for those employers subject to the state rules will be paid by the government to the insurer rather than to the employer.

To qualify for the subsidy, an employee must have been involuntarily terminated on or after September 1, 2008, and on or before December 31, 2009, and must elect COBRA coverage. An employer-initiated layoff is generally treated as an involuntary termination of employment. Employees who are let go due to gross misconduct or who voluntarily resign are not eligible. Although eligibility for the subsidy is determined retroactively to the date of termination, reimbursement of the health insurance premium applies only to coverage beginning on or after March 1, 2009.

For a limited retroactive period, individuals who were terminated on or after September 1, 2008, and before February 17, 2009, and who declined or discontinued COBRA coverage, must be notified that they have the right to opt back into the plan. The employer is to furnish the COBRA notice by April 18, 2009, which commences a 60-day period in which the employees may elect coverage.

The 2009 Act requires employers to communicate the following information to all eligible terminated employees:

- Description of the eligibility rules for the 65% subsidy;
- The individual's ability to make a COBRA continuation election even if it was initially declined;
- The option to elect other coverage at the same or lower premium rate if available;
- The mechanism for electing the subsidy;
- The former employee's obligation to notify the plan if covered by other health insurance (which would terminate the COBRA arrangement).

To assist employers, the U.S. Department of Labor has issued sample notices. *See* http://www.dol.gov/ebsa/cobra.html.

The 2009 Act provides a payroll tax mechanism for reimbursing the employer or the health plan for the difference between the full premium and the amount paid by the employee. The credit for payment of the 65% COBRA premium is treated as a payment of payroll taxes and is applied as a deposit made on the first day of the quarter. Thus, normal payroll tax deposits may be reduced by the amount of the credit. Employers are to use revised Form 941, "Employer's Quarterly Federal Tax Return," to report their COBRA premium assistance

payments beginning with the first quarter of 2009. They should enter the amount of the credit claimed and the number of individuals that were provided COBRA assistance on lines 12a and 12b. If the credit exceeds the payroll taxes that are due, the IRS will issue a refund. If, however, an employer has unpaid employment or income taxes, any credit claimed for the COBRA subsidy on Form 941 will offset the unpaid taxes before any refund will be made. The COBRA subsidy will not impact the employer's FUTA liability.

Employers entitled to reimbursement of COBRA premiums for any period will be subject to certain recordkeeping and reporting requirements under IRS rules. For example, employers must maintain supporting documentation including a record of the 35% share of the premium paid by each eligible individual and proof of the timely payment by the employer of the full premium on the health plan.

The 65% premium is generally not included in the terminated employee's income for federal tax purposes. However, the 65% employer subsidy is subject to payback by individuals whose Form 1040 income exceeds $125,000 (single) or $250,000 (married). This recapture amount is phased in as income moves from $125,000 to $145,000 (single) and from $250,000 to $290,000 (married). Any amount recaptured must be repaid in full as additional regular tax that may not be offset by personal tax credits.

The IRS, on its website, www.irs.gov, has added a series of 58 Questions & Answers (Notice 2009-27) explaining how employers are to administer this new premium subsidy program under the 2009 Act. Please let us know if you have any questions regarding these complex COBRA premium reimbursement rules.

Business Energy Credits

Congress continues to improve the Business Energy Tax Credit (IRC §48). In late 2008 legislation, this credit was enhanced to offset all tax, both regular and AMT. Further, geothermal heat pumps and wind turbine electricity generators were added as eligible property.

And now, in the 2009 Act, there were further enhancements, such as dropping the $4,000 annual credit limit on small wind turbines that generate electricity. In general, a full 30% tax credit is now available for business energy property such as solar equipment for several purposes (producing electricity, heating or cooling, or interior lighting), and small wind turbines for producing electricity. A 10% tax credit applies for geothermal heat pumps. As an example, a business that installs $40,000 of solar equipment in 2009 may claim a $12,000 energy credit. This tax credit effectively represents a direct subsidy for the expenditure.

Improved Jobs Tax Credits

For many years, the tax law has provided a Work Opportunity Tax Credit to employers who hire a worker who has been designated as within a disadvantaged category. The tax credit is generally up to $2,400 (40% of the first $6,000 of wages), although some categories can be greater. The credit applies to new hires such as food stamp recipients, qualified veterans, and other hard-to-employ categories.

The 2009 Act has added two more qualifying categories of workers to the former list of nine categories: Unemployed veterans and disconnected youth who are hired in 2009 or 2010. Unemployed veterans are those discharged from active duty within the last five years who have received unemployment benefits for at least four weeks in the year prior to hire. Disconnected youth are those age 16 through 24, lacking basic skills, who have been both unemployed and not attending school in the six months prior to hire.

In all cases, for a new hire to qualify for this tax credit, the worker must be certified as eligible by the state workforce agency. If the worker was not certified before hire, the employer can request the certification, but must do so using IRS Form 8850, Pre-Screening Notice, within 28 days after the start of employment.

If you would like further information regarding these business credits, please let us know.

Godfrey Hammel, Danneels & Company, P.C.