

Legislation and Lots of It

Our Congress has many jobs, one of which is writing new laws to help represent its constituents. These laws typically deal with situations that help people through tough times or conditions beyond their control. As a people, we elect representatives and give them the power to accomplish things. This year many laws were proposed and passed.

As it relates to taxes, our legislative process passed 5 major laws. The 2008 tax laws started with the Economic Stimulus Act of 2008 in February. Most of us were to benefit from this law as the government handout was supposed to spur the economy by the recipients spending the money. This law also provided business benefits that dealt primarily with bonus depreciation deductions.

By May 2008, the Food, Conservation, and Energy Act of 2008 was passed. This law brought about favorable tax provisions for farmers, enhanced charitable contribution deductions of certain land easements, favorable capital gains rules on timber sales and Kansas storm relief. One of the biggest benefits of this law is that it ensures that assets of the Social Security trust fund will be protected, by defining specific amounts that will be transferred from the Federal General Fund into Social Security from 2009 through 2013.

A month later, in June 2008, the Heroes Earnings Assistance and Relief Tax Act of 2008 was passed. This law provides tax benefits for those in the military.

In July 2008, the Housing Assistance Tax Act of 2008 (Housing Act) was passed. This Act put into effect several key benefits, such as the first-time homebuyer tax credit, property tax deduction for non-itemizers, accumulated alternative minimum tax (AMT) credits for business, and research and development tax credits to make investments that qualify for bonus depreciation allowances.

On October 3, President Bush signed a massive financial rescue package – Emergency Economic Stabilization Act of 2008 (EESA). This law authorizes the Secretary of the Treasury to, among other things, extend certain expiring tax provisions and puts in place a temporary AMT fix. This law also takes some of the benefits from the Housing Act and extends them through 2009. Overall, this law contains over 290 changes to the tax code.

We continuously track tax laws and how they apply to our clients and how clients can benefit from them. By doing so, we make sure that our clients are in compliance with the law, are covering their expected tax liabilities and are taking full advantage of the tax benefits that accrue to them.

~ Paul E. Hornbuckle, CPA
Tax and Business Services Manager

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Zero Capital Gains Tax

There is a new zero tax rate on long term capital gains for some investors who fall in the 10% to 15% tax brackets. The vast majority of American taxpayers fall into this category. Under the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) passed by Congress in May 2006, taxpayers in the two lowest tax brackets will pay no capital gains tax on long term investments sold in the tax years 2008, 2009 and 2010.

The maximum capital gain rate for assets held longer than one year has been 15% in the past. This rate had applied to taxpayers in the 25% and higher tax bracket. Taxpayers in the 10% to 15% tax bracket only had to pay 5% on long term capital gains. For 2008, they will pay 0%.

The new zero tax rate also applies to qualified dividend income. Married taxpayers filing joint returns with taxable income under \$65,100 and single taxpayers with taxable income under \$32,550 qualify for the 15% tax bracket; therefore, they will qualify for the zero tax rate on both their capital gains and qualified dividends.

The middle income investors/taxpayers have an opportunity to sell some of their appreciated investments without paying any capital gains taxes over a three year period. A person retiring might have stocks that have greatly appreciated and he/she could benefit by having to pay little, if any tax on the gain. This, of course depends on the size of the gain in relation to other items in their tax return.

According to the IRS, taxpayers in the 10% to 15% tax brackets accounted for 63%

of all individual income tax returns filed in 2003. This is a very large number of taxpayers who stand to benefit from the 0% tax on capital gains.



Tax Incentives

First-time homebuyer tax credit:

One tax incentive in the new law, the first-time homebuyer tax credit, has received a lot of attention in the news, but be careful. The credit, while generous, is essentially an interest-free loan from the government. Taxpayers who take the credit, which equals 10% of the purchase price (up to \$7,500 for single individuals and married couples filing jointly; \$3,750 for married individuals filing separate returns) *must repay the credit*. They will have 15 years to repay the credit, in equal amounts. If a taxpayer sells his or her home before the end of the 15-year period, he or she will likely have to immediately repay any outstanding balance. Important income thresholds also apply.

Additionally, the credit is temporary and applies to homes purchased on or after April 9, 2008 and before July 1, 2009. There are also complex rules about who can take it, when it can be claimed and so on.

Please contact our office if you have any questions about this potentially valuable, but complicated new credit.

Home sale exclusion:

The home sale exclusion is one of the most popular tax breaks in the Tax Code. A married couple filing jointly can generally exclude up to \$500,000 in gain (single individuals up to \$250,000).

Before the new law, if a second home became a principal residence, after two years the owner could sell it and could exclude up to \$250,000 in gain from his/her income or up to \$500,000 for couples filing jointly. The Housing Act closes what some call a “loop hole.” The new law prorates the exclusion between the time that a home is used as a principal residence and the total time of ownership, which includes any “non-qualifying” use as a rental or vacation property. As good news to those who have already owned property for a while and have seen it appreciate, non-qualifying use before the January 1, 2009 effective date of the provision is not used in the calculation; neither are periods after a qualified use of the property or temporary absences of less than two years.



Property deduction for non-itemizers:

The new standard property deduction for taxpayers who do not itemize deductions is significantly less complicated. Before the new law, only itemizers could deduct state and local property taxes. The Housing Act gives non-itemizers a limited deduction

for state and local property taxes by increasing the amount of their standard deduction by the lesser of the amount of property taxes they paid or \$500 (\$1,000 for a married couple filing jointly). If you have paid off your mortgage and no longer itemize, you might benefit from this new deduction. This law change put into effect by the Housing Act is for 2008 only, but was extended through 2009 by EESA.

Borrowers:

Many homeowners are trying to refinance mortgages that offered low teaser rates, but whose rates have now skyrocketed. The new law authorizes states to issue \$11 billion more in mortgage revenue bonds for 2008. It also allows qualifying sub-prime borrowers to use their state's mortgage revenue bond program to refinance into a loan with a more favorable rate. The housing bill also creates a new program called "HOPE for Homeowners" to help homeowners refinance their mortgages. Both provisions are temporary.

Non-Business Energy Property Credits

EESA extended these credits through 2009. A credit of up to \$500 for purchasing energy saving products, such as windows, insulation and HVAC systems is provided.

EESA also added two new types of improvements that qualify for the credit:

1. Biomass fuel stoves with a thermal efficiency rating of 75% or more, and
2. Asphalt roofs with cooling granules.

The bill also specifies that water heaters must have either an energy factor of at least 0.80 or a thermal efficiency rating of at least 90% to qualify for the credit.



Teacher's Expenses

EESA extends the above-the-line deduction for teacher's out of pocket classroom-related expenses through 2009. This deduction applies to qualifying expenses incurred by teachers, counselors and principals in K-12 grade schools. The deduction amount remains the same as in prior years at \$250 for materials and supplies.

Cost Basis Reporting

Under current law, every entity doing business as a broker must report gross proceeds from the sale of securities and must file an information return (Form 1099-B) in accordance with IRS regulations. Under the EESA, every broker is required to keep track of the cost basis of stocks, bonds, mutual funds and other securities using either the first-in first-out method or the average cost method. In addition, the broker will need to specify whether the gains are long-term or short-term. This reporting will be phased in from 2011 to 2013.

Brokers will be required to furnish customers with the Form 1099-B by February 15th, instead of today's January 31st deadline. Additionally, when

investors transfer their securities from one broker to another, the former broker will need to provide the new broker with the required cost basis information.

We have been reporting cost basis, gross proceeds, dates of acquisitions and sales, as well as gains and losses for years before it was ever required.

Tax-free Fringe Benefits for Bicyclists

EESA would add a new tax break for people who commute by bicycle. Employers can provide tax-free fringe benefits of up to \$20 per month to cover "reasonable expenses incurred by the employee". These include the purchase, improvement, repair, and storage of a bicycle that is regularly used to commute between the employee's home and office. This section of the tax code also provides tax-free benefits of up to \$100 for transit passes and up to \$175 in parking benefits per month, which remains unchanged. This bicycle fringe benefit will begin in 2009. Fringe benefits for commute and transit expenses are excluded from an employee's wages.



New Tax Credit for Electric Vehicles

EESA provides a new tax credit worth \$2,500 to \$7,500 for plug-in electric vehicles. The credit will start to phase

out after 250,000 of the qualifying electric vehicles are sold. Individuals can use the credit to offset AMT. Vehicles that qualify will need to be certified under the Clean Air Act and will have to meet the California low-emission standards.

Business Contributions

The Tax Code gives businesses enhanced deductions for contributions of food to charitable organizations, as well as contributions of books and computer equipment to qualifying schools. EESA extends these tax breaks through December 31, 2009. S-Corporation shareholders are also eligible for special tax treatment when making charitable contributions of qualifying property. The new law extends the special rule allowing S-Corporation shareholders to take into account their pro rata share of charitable deductions even if the deduction amount exceeds the shareholder's adjusted basis in the S-Corporation through December 31, 2009.

The AMT Fix

The alternative minimum tax (AMT) represents the excess of the tentative minimum tax over the regular tax, for the year. The tentative minimum tax is calculated based on the regular taxable income, modified by various adjustments and preferences, and then subtracts an exemption amount to determine the alternative minimum taxable income which is subject to a 26% or 28% tax rate. The fix involves the exemption amount. At the end of 2007, the prior

temporary fix expired, thus exemption amounts reverted to 2000 amounts - \$45,000 for married individuals and \$33,750 for unmarried individuals. For 2008, EESA raised the temporary fix exemptions to \$69,950 for married individuals and \$46,200 for unmarried individuals. In 2009, unless Congress takes action, the AMT exemptions will again drop back to 2000 levels.

2009 Inflation Adjustments Widen Tax Brackets

For 2009, personal exemptions and standard deductions will rise, and tax brackets will widen because of inflation adjustments announced by the Internal Revenue Service.

By law, the dollar amounts for a variety of tax provisions must be revised each year to keep pace with inflation. As a result, more than three dozen tax benefits affecting virtually every taxpayer, are being adjusted for 2009. Key changes affecting 2009 returns, filed by most taxpayers in early 2010, include the following:

- The value of each personal and dependency exemption available to most taxpayers is \$3,650, up \$150 from 2008.
- The new standard deduction is \$11,400 for married couples filing a joint return (up \$500), \$5,700 for singles and married individuals filing separately (up \$250), and \$8,350 for heads of household (up \$350). Nearly two out of three taxpayers take the standard deduction, rather than itemizing deductions

such as mortgage interest, charitable contributions and state and local taxes.

- Tax bracket thresholds increase for each filing status. For example, for a married couple filing a joint return, the taxable income threshold separating the 15% bracket from the 25% bracket is \$67,900, up from \$65,100 in 2008.
- The maximum earned income tax credit for low and moderate income workers and working families with two or more children is \$5,028, up \$204. The income limit for the credit for joint return filers with two or more children is \$43,415, up \$1,769.
- The annual gift exclusion rises to \$13,000, up from \$12,000 in 2008.

Our location at 350 West Church Street has become familiar to our clients. With adequate parking in the back, it is a convenient location to meet with tax preparers to discuss tax questions and solutions.

Please call our office at (607) 733-9022 in order to set up appointments and to speak directly with one of our tax specialists.



Located at the northwest corner of West Church and Columbia Streets.

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