TaxTips

Keeping you informed...

Winter 2009/2010

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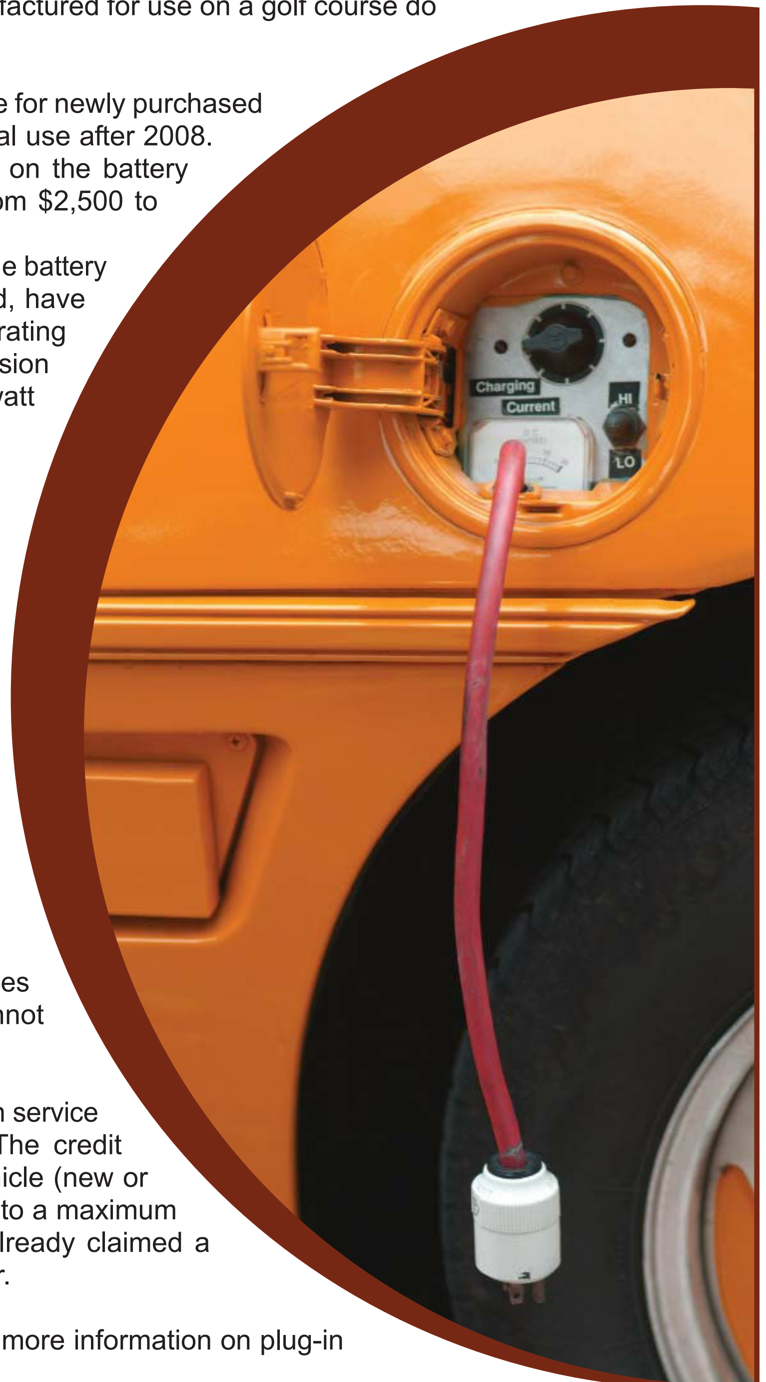
Plug-in Electric Vehicle Credits

Go green and save!

You may be able to claim one of three credits for plug-in electric vehicles manufactured primarily for use on public streets, roads, and highways. Vehicles manufactured for use on a golf course do not qualify.

(1) The plug-in electric drive motor vehicle credit is available for newly purchased qualified vehicles placed in service for business or personal use after 2008.

- For 2009, the amount of the credit varies depending on the battery capacity and the weight of the vehicle and ranges from $2,500 to $15,000.
- After 2009, the credit tops out at $7,500, depending on the battery capacity. To qualify, vehicles must be newly purchased, have four or more wheels, have a gross vehicle weight rating (GVWR) of less than 14,000 pounds, and draw propulsion using a rechargeable battery with at least four kilowatt hours.



(2) The plug-in electric vehicle credit is available for certain vehicles purchased after February 17, 2009, and before January 1, 2012. The credit equals 10 percent of the cost of a new vehicle, up to a maximum credit of $2,500. You can either purchase:

- Certain low-speed vehicles (i.e., four-wheeled vehicles with a GVWR of less than 3,000 pounds) that are propelled to a significant extent by a rechargeable battery with a capacity of at least 4 kilowatt hours; or
- A two- or three-wheeled vehicle (i.e., motor scooter, motorcycle, etc.) with a GVWR of less than 14,000 pounds that is propelled to a significant extent by a rechargeable battery with a capacity of at least 2.5 kilowatt hours.

For 2009, you cannot claim this credit for a vehicle that qualifies for the plug-in electric drive motor vehicle credit. You cannot claim both credits for the same vehicle.

(3) The plug-in conversion credit applies to property placed in service after February 17, 2009, and before January 1, 2012. The credit equals 10 percent of the cost of converting any motor vehicle (new or used) to a qualified plug-in electric drive motor vehicle, up to a maximum credit of $4,000. You may claim this credit even if you already claimed a hybrid vehicle credit for the same vehicle in an earlier year.

Check out www.pluginamerica.org and www.eaaev.org for more information on plug-in electric vehicles.

Making Work Pay Credit and Pensions

Should you adjust withholding?

In February 2009, the government reduced the withholding tables for the Making Work Pay Credit. If you are receiving a pension and have no earned income, you do not qualify for the Making Work Pay Credit. However, if you have withholding from your pension payments, you may not have enough, and may end up owing more taxes when you file your tax return.

Pension payors were provided an optional procedure for additional withholding on pension payments to offset the withholding reductions for the Making Work Pay Credit. However, they are not required to use this procedure, so you should check with your pension plan administrator.

If your pension payor does *not* use the optional adjustment procedure, you can increase your withholding by filing Form W-4P, *Withholding Certificate for Pension or Annuity Payments*. If you submitted a Form W-4P to request additional withholding after the 2009 February withholding tables were issued, and your pension payor is using the optional adjustment procedure, you may want to submit a new Form W-4P to get rid of the additional withholding.

Earned Income Credit (EIC)

Should you request an advance payment?

In 2009 and 2010, there is an increased EIC for taxpayers with three or more qualifying children. The EIC reduces the tax you owe, and gives you a refund even if you do not owe any tax. In 2009, you may be able to claim the credit if:

- You have three or more qualifying children and your earned income and adjusted gross income (AGI) are less than $43,279 ($48,279 if married filing jointly). The most you can get is $5,657.
- You have two qualifying children and your earned income and AGI are less than $40,295 ($45,295 if married filing jointly). The most you can get is $5,028.
- You have one qualifying child and your earned income and AGI are less than $35,463 ($40,463 if married filing jointly). The most you can get is $3,043.
- You have no qualifying children and your earned income and AGI are less than $13,440 ($18,440 if married filing jointly). The most you can get is $457.

If you think you will be eligible for the EIC and you have at least one qualifying child, you may choose to get advance EIC payments (up to $1,826) with your pay by completing Form W-5, *Earned Income Credit Advance Payment Certificate*, and giving it to your employer. If you are entitled to an EIC greater than the amount advanced, you may claim the additional amount on your 2009 tax return.

Be careful requesting advance EIC payments! If you get advance payments and you are not eligible for the EIC, you must pay back these payments when you file your 2009 tax return. First, consult your tax professional to make sure you qualify for the EIC.

Qualifying Child

Do you need to adjust your withholding?

If you want to claim someone as a dependent, the individual must be a qualifying child or a qualifying relative. In 2009, the definition of a qualifying child was revised. Now:

- Your qualifying child must be younger than you;
- A child cannot be your qualifying child if he or she files a joint return, unless the return was only filed to claim a refund; and
- If the parents can claim the child as a qualifying child but no parent so claims the child, no one else can claim the child as

a qualifying child unless that person's AGI is higher than the highest AGI of any parent of the child.

These new provisions generally affect siblings and grandparents. Those parents who didn't benefit from the dependency exemption because their income was too high can no longer have a younger child claim an older sibling as a qualifying child to benefit from the earned income credit (EIC). In addition, siblings and grandparents cannot claim a child as a qualifying child if the parents can claim the child and either of the parent's AGI is higher than the sibling's or the grandparent's. If you are affected by these provisions, you may need to adjust your withholding.

0-Percent Capital Gains Rate

Tax-free step-up in basis?

If you have owned stock with a low basis for more than a year and think the stock will continue to go up in value, now may be the time to sell it if all of the gain on the sale falls within the 10- or 15-percent income tax brackets. In this case, the gain on the sale is taxed at the 0-percent capital gains rate. In addition, if you buy the stock right back, you effectively receive a tax-free step-up in basis.

You may be thinking that the gain on the sale is disallowed under the wash sale rules when you buy identical stock within 30 days of selling it. However, the wash sale rules only disallow losses on such sales.

The 0-percent capital gains rate is available through 2010. To qualify for the 0-percent capital gains rate in 2009, your income (including long-term capital gains) must be under $33,951 (single and married filing separately), $67,901 (married filing jointly), and $45,501 (head of household). Ordinary income uses up the 10- and 15-percent income tax brackets before long-term capital gains, so if you have a lot of W-2 income, you will not qualify for the 0-percent capital gains rate.

Section 1202 Gain Exclusion

Thinking of selling qualified small business stock?

It may be wise to hold off selling your qualified small business stock if it is issued in 2009 or 2010. In general, you can exclude 50 percent of the gain on the sale of qualified small business stock that was held for more than five years. However, the remaining 50 percent of the gain is taxed at the 28-percent capital gains rate, so the entire gain on the sale is effectively taxed at a rate of 14 percent.

For qualified small business stock issued *after* February 17, 2009, and *before* January 1, 2011, the 50-percent exclusion is increased to 75 percent. Thus, only 25 percent of the gain is taxed at the 28-percent rate, which effectively taxes the entire gain at a rate of 7 percent. You still need to hold the stock for five years, so you'll have to project your tax situation five years from now to determine if it's worth the wait.

QUIK TIPS

1 In general, if an inherited IRA has several nonspouse designated beneficiaries, each beneficiary must take required minimum distributions (RMDs) over the oldest beneficiary's (the shortest) life expectancy. However, if you set up separate accounts with separate beneficiaries by the end of the year following the year of death, you can take RMDs from your separate account over your life expectancy. This allows you to stretch out your payments if you are younger. In addition, there are no RMDs for 2009 because they were waived.

2 If you are at least 70½ years old, you can still make tax-free charitable distributions of up to $100,000 from your IRA through December 31, 2009. The distribution must be made directly by the trustee of your IRA to the charitable organization.

3 You can deduct employment agency fees and amounts paid for preparing your resume while looking for a new job in your present occupation. You can also deduct the cost of traveling to and from an area if the trip is primarily to look for a new job. However, you cannot deduct job search expenses if you are looking for a job for the first time, or in a new occupation.

4 You can rent out your principal residence for a couple years before selling it and still exclude up to $250,000 of gain ($500,000 if married filing jointly) if you owned and used it as your principal residence for at least two out of five years ending on the date of sale. However, any gain due to depreciation and periods of nonqualified use must be recognized.

5 If you have an office in your home that is your principal place of business, you may deduct transportation expenses incurred in going between your home office and any other work location in the same trade or business.

Exercising an Incentive Stock Option?

How to avoid the alternative minimum tax (AMT)

In general, when you buy stock by exercising an incentive stock option (ISO) and don't sell that stock in the same year, you could be subject to AMT. For regular tax purposes, no income is recognized when an ISO is exercised. However, additional income is recognized for AMT purposes equal to the excess of the stock's FMV on the date of exercise over the exercise price. Therefore, you may be taxed on income you haven't even received (phantom income).

Don't be caught off guard and end up with an unexpected tax liability when you go to file your tax return. If you exercised an ISO early in the year and the stock has been rapidly declining ever since, consider selling the stock before the end of the year. There is no AMT adjustment when stock that was acquired by exercising an ISO is sold in the same year, so you can avoid paying tax on phantom income. Otherwise, if you want to hold onto the stock and don't want a big tax liability at year-end, you can make estimated tax payments. Also, the additional tax triggered by the AMT adjustment for ISOs generates a minimum tax credit (MTC) that may reduce your regular tax in future years.

Note: If you owed AMT attributable to the exercise of ISOs for 2007 or any prior year, the amount still owed as of October 3, 2008, was abated. However, your MTC must be reduced accordingly. In addition, any unpaid interest and penalties with respect to such unpaid AMT as of October 3, 2008, were abated. If you already paid such interest and penalties, you can increase your MTC. You should have received a Letter 2719C from the IRS detailing the amount of tax, interest, and penalties that were abated.

Roth IRAs

Is this a good place to put your money?

Roth IRAs can be more beneficial than other retirement accounts because qualified distributions are not taxable, and you don't have to take required minimum distributions when you reach the age of 70½. However, you cannot make a Roth IRA contribution when your income exceeds certain limits. For 2009, the Roth IRA contribution limit is phased out (reduced) when your modified adjusted gross income (AGI) is between $105,000 and $120,000 ($166,000 and $176,000 if married filing jointly).

If your income is too high to make a Roth IRA contribution for 2009, you can still make a contribution to a traditional IRA. In general, the contribution will be nondeductible if you or your spouse is covered by a retirement plan at work, but it will give you basis in the IRA. On the other hand, if you and your spouse are *not* covered by a retirement plan at work, the contribution will be fully deductible regardless of your AGI.

For 2010 and beyond, the $100,000 modified AGI limit on converting a traditional IRA to a Roth IRA has been eliminated, so you can convert that 2009 traditional IRA contribution to a Roth IRA in 2010 regardless of your AGI.

You must recognize the amount converted, except any basis, as income. However, any taxable income from a 2010 conversion will be included in gross income ratably over a two-year period beginning in 2011, unless you elect out of the two-year period and include all of it in 2010. This two-year rule only applies to 2010 conversions. Examine your tax situation to determine which year(s) to recognize any taxable income from a 2010 conversion.

The information contained in this newsletter is not intended to provide specific tax advice or to take the place of either the written law or regulations.