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## **What's New for the 2009 Income Tax Return and the 2010 Tax Year**

2009 presents challenge for individuals and businesses must take into account the many tax changes that take effect for 2009. The challenge is heightened by the deluge of recent tax laws as well as recent rulings and other important developments that affect both the 2009 return and the 2010 tax year. Recent tax laws that impact the 2009 return and the 2010 tax year are as follows:

- The American Recovery & Reinvestment Act; and
- Worker, Homeownership, and Business Assistance Act of 2009;

Although not all of these tax law changes will affect your return it is important to note the number of changes to the tax laws that have been enacted recently.

This tax planning guide summarizes what's new for the 2009 return, as well as what's new for the 2010 tax year.

### **1. Tax Credit for Workers.**

For 2009 and 2010 there is a "making work pay" tax credit of up to \$400 for working individuals and \$800 for couples filing joint returns. The credit was advanced to most taxpayers through reduced withholding throughout the year.

### **2. Alternative Minimum Tax.**

The exemption amounts for individuals increase for 2009. For 2009, the maximum AMT exemption amount is \$70,950 for married individuals filing jointly and surviving spouses, and \$46,700 for unmarried individuals.

### **3. Deduction for sales and use taxes available through 2009.**

Taxpayers were allowed an option to claim an itemized deduction for state and local sales and use taxes instead of state and local income taxes. This deduction is available through 2009.

**4. Above-the-line deduction for expenses of educators available through 2009.**

The above-the-line deduction for expenses of educators is deductible for 2009 up to \$250.

**5. American Opportunity Tax Credit for higher education expenses.**

For 2009 and 2010, the American Opportunity Tax Credit expands the tax breaks under the Hope credit for individuals seeking a college education. The credit increases the Hope credit to up to \$2,500 of the cost of tuition and related expenses paid during the tax year, including expenditures for course materials—i.e., books, supplies, and equipment needed for a course of study, whether or not purchased from the educational institution as a condition of enrollment or attendance. Individuals receive a tax credit based on 100% of the first \$2,000 of tuition and related expenses (including books) paid during the tax year and 25% of the next \$2,000 of tuition and related expenses paid during the tax year. The credit is available for the first four years of post-secondary education in a degree or certificate program (rather than just the first two years). Forty percent of the credit is refundable, which means that a taxpayer can receive up to \$1,000 even if no taxes are owed. However, none of the credit is refundable if the taxpayer claiming the credit is a child (a) who is under age 18 (or a student who is at least age 18 and under age 24 and whose earned income does not exceed one-half of his or her own support), (b) who has at least one living parent, and (c) who does not file a joint return. The credit is phased out (gradually reduced) if modified AGI is between \$80,000 and \$90,000 (\$160,000 and \$180,000 if married filing jointly).

**6. 529 Plans.**

A qualified higher education expense now consists of qualified computer technology and equipment. Therefore, distributions from a 529 Plan to purchase a computer will not be taxable.

**7. Standard deduction for property taxes available through 2009.**

Homeowners can choose between itemizing and taking the standard deduction. The standard deduction now includes a new “standard deduction” for property taxes.

The regular standard deduction is \$11,400 for married filing jointly for 2009, plus another \$1,000 for the property tax deduction. For single filers, the standard deduction is \$5,700, plus another \$500 for the property tax deduction. In addition, a taxpayer may be able to increase his standard deduction by new motor vehicle taxes paid in 2009.

**8. Deduction for taxes on purchase of new motor vehicles.**

In 2009, an individual can deduct the state or local sales and excise taxes imposed on the purchase of a qualified motor vehicle after Feb. 16, 2009, and before 2010. A qualified motor

vehicle includes a passenger automobile, light truck, or motorcycle, the original use of which begins with that purchaser and that has a gross vehicle weight rating of 8,500 pounds or less. A qualified motor vehicle also includes a motor home, the original use of which begins with that purchaser. The amount of tax an individual can deduct is limited to the tax that is imposed on the first \$49,500 of the purchase price of the vehicle. The deduction is phased out over a \$10,000 range that begins when modified AGI is more than \$125,000 (\$250,000 if married filing a joint return). No deduction is allowed when modified AGI is equal to or more than \$135,000 (\$260,000 if married filing jointly). The deduction can either increase the amount of a taxpayer's standard deduction or be taken as an itemized deduction (if the taxpayer isn't electing to take the state and local general sales tax deduction).

## **9. First-time homebuyer credit.**

On November 6, 2009 President Obama signed a bill extending the federal tax credit for first-time home buyers. Prior to the signing of the bill there was no extension of time on the November 30, 2009 date. With the extension of the tax credit a taxpayer must enter into a purchase agreement by April 30, 2010 and close and take possession by June 30, 2010.

In analyzing the first-time home buyers credit the first issue is to make sure that one qualifies for the credit. First, to qualify for the first-time home buyer credit one has to be a first-time home buyer. A first-time home buyer is someone who has not owned a primary residence in the last three years. In addition, there is an income limit test. To qualify for the full credit, for purchases after November 6, 2009 a taxpayer's adjusted gross income, if married, must be less than \$225,000. For a single individual, the income limit is \$125,000.

If the taxpayer meets the aforementioned tests then the taxpayer is eligible for the tax credit. The credit is 10 percent of the purchase price, up to a maximum of \$8,000. Therefore, if the taxpayer bought a home for \$100,000 and meets the income test, taxpayer would qualify for an \$8,000 credit. At the end of the year, if taxpayer did not owe money in taxes, the government would send a check for the amount of the credit.

Under the new law the price of a home cannot exceed \$800,000. There was no price limit under the old law.

The new law also provides that current home owners may purchase another home to live in and also receive a credit. If a home owner has owned their current home for at least five consecutive years as their primary residence out of the 8 years before buying and moving into a new principal residence a \$6,500 tax credit is available. The credit is 10 percent of the purchase price, up to a maximum of \$6,500 in this instance. The homeowner is not required to sell or dispose of their current home, but the new home must become their principal residence.

The first-time homebuyer's credit is certainly an incentive for many people to purchase homes. However, time is of the essence. According to federal tax law, in order to qualify for the credit, a purchase agreement must be entered into by April 30, 2010. In addition, the buyer must close on the house and take title of the home prior to June 30, 2010. For those people who have not already found a house and started the mortgage process, with the extension of the law you now have additional time to find a home.

Another benefit of the new law is to get the credit (or income tax refund) in the home owner's possession as soon as possible. If you purchase a home prior to the April 30, 2010 (and close by June 30, 2010) deadline you may treat it as purchased in 2009. The purpose of this is to report the purchase on your 2009 income tax return (or amended tax return for 2009 if purchased after filing your income tax return) even if you purchased the home in 2010. By treating it in this way you will receive the credit sooner. Otherwise, you would have to file your 2010 income tax return in 2011.

#### **10. Energy home improvements credit.**

Qualifying products purchased between January 1, 2009 and December 31, 2010 are eligible for a tax credit equal to 30 percent of the product cost. Energy-efficient windows, doors, skylights, roofing, insulation, HVAC, and water heaters are some of the qualified products. Installation is not included so it is important to obtain an itemized invoice for the product cost. The maximum amount of credit for all improvements combined is \$1,500 during 2009 and 2010.

#### **11. Unemployment compensation.**

In 2009 a recipient of unemployment compensation can exclude up to \$2,400 from income.

#### **12. Key traditional IRA income limits.**

In general, an individual who isn't an active participant in certain employer-sponsored retirement plans, and whose spouse isn't an active participant, may make an annual deductible cash contribution to an IRA up to the lesser of: (1) a statutory dollar limit (for 2010, \$5,000, increased to \$6,000 for those age 50 or older), or (2) 100% of the compensation that's includible in his gross income for that year. If the individual (or his spouse) is an active plan participant, the deduction phases out over a specified dollar range of modified adjusted gross income (MAGI).

For 2009, the phaseout for joint return filers begins at MAGI of \$89,000 and \$109,000 (and for 2010 between \$89,000 and \$109,000); for 2009 for taxpayers who are single or heads of households, the phaseout begins at MAGI of \$55,000 and \$65,000 (and for 2010 between \$56,000 and \$66,000).

For married taxpayers who are not active plan participants but whose spouse is such a participant, the IRA deduction phaseout begins at MAGI of \$166,000 and \$176,000 for 2009 (for 2010 between \$167,000 and \$177,000).

Married taxpayers can each make deductible contributions to separate IRAs, subject to the deduction phase-out rules that apply if either or both are active participants in an employer retirement plan for any part of the tax year.

#### **13. Income limit for Roth IRA contributions.**

Individuals with adjusted gross income below certain levels may make nondeductible contributions to a Roth IRA, subject to the overall limit on IRA contributions. The maximum annual contribution that can be made to a Roth IRA is phased out for taxpayers with modified adjusted gross income (MAGI) over certain levels for the tax year. The MAGI phase-out ranges

are: (1) for single taxpayers, \$105,000 to \$120,000 for 2009 and \$105,000 to \$120,000 for 2010; (2) for married taxpayers filing joint returns, \$166,000 to \$176,000 for 2009 and \$167,000 to \$177,000 for 2009; and (3) for married taxpayers filing separate returns, \$0 to \$10,000 for 2009 and 2010.

While income limits prevent some individuals from making contributions to a Roth IRA, the law effectively eliminates the limits—after 2009, an individual will be able to convert a traditional IRA into a Roth IRA regardless of how much income he has. Thus, a high-income individual who made nondeductible contributions to a traditional IRA prior to 2010 may then convert the IRA to a Roth IRA in 2010. Only earnings on the IRA will be taxable on the conversion.

**14. Retirement plan contribution limits.**

	2010	2009
IRA (under age 50)	\$5,000	\$5,000
IRA (age 50 and over)	\$6,000	\$6,000
SIMPLE (under age 50)	\$11,500	\$11,500
SIMPLE (age 50 and over)	\$14,000	\$14,000
401(k) (under age 50)	\$16,500	\$16,500
401(k) (age 50 and over)	\$22,000	\$22,000

## **OTHER ITEMS TO CONSIDER FOR 2009**

### **1. Kiddie Tax.**

The age at which children are subject to the “kiddie tax” is age 19 or full-time students under age 24 if they can be claimed as dependents. A child is subject to the kiddie tax if he or she is under age 19 before December 31 or if a full-time student whose earned income does not exceed half of his or her own support for the year, under age 24. The kiddie tax doesn’t apply to a child who is married and files a joint return for the year.

A child subject to the kiddie tax pays tax at his or her parents’ highest marginal rate on the child’s unearned income over \$1,900 (for 2009) and \$1,900 (for 2010) if that tax is higher than the tax the child would otherwise pay on it. The parents can instead elect to include on their own return the child’s gross income in excess of \$1,900 (for 2009) and \$1,900 (for 2010).

Parents may directly pick up on their own returns the income of the child to whom the kiddie tax applies. To elect this option, the parent must file Form 8814 along with the parent’s regular tax return.

For 2009 and 2010, a parent may elect to include the income of a child under age 19 on the parent’s own return if all of the following conditions are satisfied:

- the child’s gross income for the tax year is more than \$950 and less than \$9,500;
- the income consists solely of interest, dividends and capital gain distributions;
- no estimated tax payment is made for the current tax year and no overpayment from the prior year was applied to the current year under the child’s name.

If the election is made for 2009 or 2010, the child’s gross income above \$1,900 must be included in the parent’s gross income. Further, the parent must pay an additional tax of either \$95 in 2009 and 2010 if the child’s taxable income is more than \$950 or 10% of the child’s income if it is less than \$950 for 2009 and 2010.

Thus, the election causes the parent to pay tax at the parent’s top marginal bracket on the picked-up income and to pay a maximum additional tax for 2009 and 2010 of \$95.

### **2. Deduction for home mortgage insurance premiums.**

For amounts paid or accrued through 2010 an itemized deduction for the cost of premiums for mortgage insurance on a qualified personal residence is deductible.

Premiums paid or accrued for qualified mortgage insurance by a taxpayer during the tax year in connection with acquisition indebtedness on a qualified residence of the taxpayer are treated as interest that is qualified residence interest and thus deductible. The amount allowable as a deduction is phased out ratably by 10% for each \$1,000 by which the taxpayer's AGI exceeds \$100,000 (\$500 and \$50,000, respectively, for separate filers).

### **3. Home mortgage debt relief.**

Taxpayers generally may exclude up to \$2 million of mortgage debt forgiveness on their principal residence. Specifically, gross income doesn't include any discharge of qualified principal residence indebtedness. Qualified principal residence indebtedness is acquisition indebtedness with respect to the taxpayer's principal residence, but with a \$2 million limit (\$1 million for married individuals filing separately). "Principal residence" has the same meaning as under the homesale exclusion rules. Acquisition indebtedness of a principal residence is indebtedness incurred in the acquisition, construction, or substantial improvement of an individual's principal residence that is secured by the residence. It includes refinancing of debt to the extent the amount of the refinancing doesn't exceed the amount of the refinanced indebtedness.

If any loan is discharged, in whole or in part, and only part of the loan is qualified principal residence indebtedness, the mortgage forgiveness exclusion applies only to so much of the amount discharged as exceeds the amount of the loan (as determined immediately before the discharge) which is not qualified principal residence indebtedness.

The exclusion doesn't apply to a taxpayer in a Title 11 bankruptcy.

The Act extends the mortgage debt relief through 2012.

### **4. Capital Gains.**

Prior to 2008, long-term capital gains from the sale of assets held longer than one year and qualified dividends were taxed at a maximum rate of five percent to the extent the seller was in the ten or fifteen percent tax brackets. In 2008, the five percent maximum rate drops to zero percent through 2010. The fifteen percent maximum tax rate on other long-term capital gains stays the same.

To be eligible for this reduction in capital gains rates, your taxable income must be \$32,550 or less for single filers, \$43,650 or less for heads of household, and \$65,100 or less for joint filers.

## **ITEMS TO CONSIDER FOR 2010**

### **1. Roth IRA conversions.**

Starting in 2010, individuals with any amount of modified Adjusted Gross Income are free to switch a traditional IRA to a Roth IRA. Conversions are fully taxable at your regular tax rate. For conversions in 2010, taxpayers can spread the tax due over two years. Half the tax will be due in 2011, and the remaining half will be payable in 2012. Removing the limit on conversions effectively eliminates the income limit on contributions to Roth IRAs. A taxpayer with income too high to use a Roth will be able to contribute to a traditional IRA (which does not have income limits for contributions) and immediately convert to a Roth.

### **2. State and local sales tax deduction.**

The opportunity for itemizers to choose to deduct their state sales tax payments instead of deducting their state and local income taxes ends after 2009, unless Congress extends it.

### **3. Educators' deduction.**

This deduction for classroom supplies purchased by educators lapses after 2009, unless Congress extends it.

### **4. Additional standard deduction for property taxes.**

Starting in 2010, non-itemizers will no longer be allowed to increase their standard deduction by up to \$1,000 of property taxes paid, unless Congress extends this break.

### **5. 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. However, these rates are scheduled to increase in 2011.

### **6. Exemptions for the Alternative Minimum Tax.**

For 2010, the exemption levels drop to \$45,000 for married filing jointly, \$33,750 for singles and heads of household, and \$22,500 for married couples filing separately. Congress, can, however, act in 2010 to extend the relief that was available in 2009.

### **7. Partial exclusion for unemployment benefits.**

For 2010, the first \$2,400 of unemployment benefits you receive is no longer tax-free.

**8. Sales tax deduction for new vehicles.**

Beginning in 2010, buyers of new vehicles no longer get a tax benefit for sales tax paid on new vehicles, unless they itemize and elect to deduct sales taxes instead of state income taxes.

**9. Credit for energy-saving home improvements.**

The 30 percent tax credit of the cost of energy-saving home improvements reverts to 10 percent after 2010, and is capped at \$500.

**10. AGI-based personal exemption phaseout and itemized deduction reduction are gone.**

For 2010, taxpayers with higher levels of AGI will no longer face a phaseout of their deduction for personal exemptions or a reduction in their itemized deductions. For 2009, the personal exemption phaseout began when AGI exceeded these threshold amounts: \$250,200 (joint return or surviving spouse), \$208,500 (head of household), \$166,800 (single) and \$125,100 (married filing separately). And the itemized deduction reduction began when AGI exceeded \$166,800 (\$83,400 for married filing separately).

**11. New modified carryover basis.**

As part of the estate tax repeal that applies for individuals dying in 2010, the income tax basis rules for property acquired from a decedent in 2010 are similar to the gift tax carryover basis rules but with many opportunities for heirs to get increases in basis. For example, it is possible to increase the basis of assets received from an individual dying in 2010 by \$1.3 million and by an additional \$3 million for assets going to a spouse. The step-up in basis rules return for 2011. In 2011 the estate tax exemption amount is \$1 million per person.