

Taxes and timing

May 2009 – For comedians, and perhaps for life in general, timing is everything. Our tax code includes innumerable examples of that, which is what contributes to its extraordinary complexity. Congress affixes special dates to some tax breaks to lower their “revenue costs.” Here are three new examples, taken from the “stimulus bill” enacted in February.

New car deduction

The purchaser of a new vehicle today, and for the rest of the year, may be entitled to a new “above-the-line” deduction for state and local sales taxes or excise taxes associated with the purchase. Taxes on leases are not eligible, however. Each taxpayer may claim the tax break on the first \$49,500 in value for any one purchase. Cars, SUVs, light trucks and motorcycles, whether foreign or domestic, generally are all eligible, provided they weigh no more than 8,500 pounds.

The tax break phases out at higher income levels. Singles with adjusted gross income up to \$125,000 and married couples with up to \$250,000 may take full advantage of this 2009 opportunity.

However, only purchases on or after the date of enactment of the stimulus bill are eligible for this tax treatment. President Obama signed the legislation on February 17, 2009, so that is the key date. Anyone who bought a new car in January is out of luck.

Why would Congress use that arbitrary date, instead of simply granting the deduction for all 2009 purchases? Because the point of the deduction is to cause new sales to happen, and the earlier sales already occurred. Those purchasers would get a slight windfall, and the IRS would get less money, if the easier-to-understand approach had been used.

First-time homebuyer tax credit

A far more costly example of this phenomenon is the first-time homebuyer credit. Last year Congress created a \$7,500 “credit” for first-time buyers, but it had to be paid back over time, beginning after three years of living in the home. So last year’s tax break was really a loan, not a credit at all, and the record shows that it did not have much impact on the housing market.

The stimulus bill ups the ante to \$8,000 and eliminates the payback requirement. Again, dates are critical. The key here is when title passes, not when the contract is signed. Home purchases that closed after December 31, 2008, are eligible for the enhanced tax treatment, while taxpayers who bought earlier in 2008 still will have to pay their credit back.

But homebuyers shouldn’t wait until the last minute, because the new credit expires on November 30, 2009 (not December 31, 2009, as one might expect). Why the 11-month window, instead of the full tax year? Presumably, to reduce revenue cost.

For both the 2008 and 2009 tax years, the homebuyer tax credit begins phasing out at \$75,000 of AGI for singles, \$150,000 for joint filers. Only time will tell whether the new credit works better than the one that it replaced.

Education credit

For the 2009 and 2010 tax years only, the HOPE education credit has been rechristened the "American Opportunity Tax Credit," and the maximum credit goes from \$1,800 for 2008 to \$2,500 for each of the next two years. The beginning of the phase-out was lifted to \$80,000 singles/\$160,000 joint filers. The scope of the credit is larger now as well. It's available for all four years of college and may be applied to course materials. To get the maximum credit, one must have \$4,000 of qualifying education expenses. The first \$2,000 of expenses creates a dollar-for-dollar credit, and the next \$2,000 generates a 25% credit, so the total is \$2,500.

The changes to the education credit were made retroactive to January 1, 2009, in the stimulus bill, and they apply to the full calendar year. But it's still not simple. Tuition that was paid for the spring semester of 2009 is not eligible for the higher credit if the payment was actually made in 2008.

No wonder so many people rely on computers to do their taxes.

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