Money Morning Outlook 2009

Tuesday, March 17, 2009

Seven Ways to Get an Income-Tax Boost From the Obama Recovery Plan

By Ron Brounes
Contributing Writer
Money Morning

So what will $800 billion buy these days? At the macro level, the Obama administration's rescue plan will buy some new roads and bridges, 3.5 million new jobs and, hopefully, an economic recovery in the process.

On an individual level, the benefit will come from the mix of tax benefits that are part of the package.

On Feb.17, U.S. President Barack Obama signed into law a massive $787 billion stimulus package aimed at jump-starting the domestic economy. While the jury is still out on its future success, average Americans are left to ask: What's the best way to benefit?

"In general, lower-income folks are more likely to see the most actual benefits from these provisions,'" said Gregory Horning, co-founder and director of SC&H Group Inc., the largest locally based management-consulting and CPA firm in Baltimore.

However, Horning believes that for the economy to really rebound, families must repair and reposition their individual financial positions.

"For years, folks have lived on no savings and counted on equity in their homes as a source of spending,'" Horning said. "Now, home valuations are down and they need to change their lifestyles and cut their monthly spending to repair their personal balance sheets. While a couple of hundred dollars from a stimulus package may help in the short-run, we must deal with the root of the problem, which requires a new mindset for the American people. There are no simple fixes; no good answers.'"

Home Buyer Credit

Even so, Horning sees a few provisions within the stimulus package that could prove beneficial to certain individuals. In particular, he points to the temporary credit for first-time homebuyers as one area that could help.

Under this provision, first-time homebuyers may be eligible for a credit of as much as $8,000 credit on the purchase of their house (or 10% of the purchase price). The credit is subject to income limitations ($75,000 for single filers/$150,000 for joint) and can be taken for homes purchased between Jan.1, 2009 and Dec.1, 2009. Because the collapse of the housing sector has been a major contributor to the economic downturn of the past few years, the government is hoping that this credit will encourage renewed housing activity.

“For first time homebuyers who qualify, this provision may accelerate their decision to pursue home ownership and live the American Dream,’” Horning said. “Essentially, the government is subsidizing $8,000 toward the purchase of a home. Coupled with the current lower property valuations, home ownership has become more attractive for this limited group of individuals.’”

Because of the income restrictions and the fact that buyers could not be prior homeowners, Horning acknowledges that the impact on housing and the overall economy will be fairly limited.

Bill Hickl is managing director leader of the Private Client Services Group for UHY Advisors, one of the 15 largest professional-services firms in the country. Though his client base is primarily high-net-worth individuals who would not qualify for this homebuyer credit, he has been fielding a number of calls about this provision.

“Just last week, I spoke with a CEO of a local business who called to talk about his daughter, who was considering becoming a first-time homeowner,’” Hickl said. “He was thinking about helping out with her down-payment and wanted to get some of the specifics. I let him know that the purchase could be treated as if it occurred in 2008 for tax purposes as the government is allowing for acceleration of the use of this credit by making an election. By extending her tax-return filing to Oct. 15, his daughter will have several months to complete the transaction and still be eligible for the credit on the 2008 return.’”

Car Buyer Deduction

Another provision aimed at stimulating additional retail activity is a temporary deduction for car buyers. Under this bill, individuals who purchase a car, recreational vehicle, or even a motorcycle in 2009 may be eligible to deduct the state and local sales taxes, as well as excise tax, on the vehicle. Again, an income limitation applies, so not every car buyer is eligible, but the higher limits ($125,000 single/$250,000 joint filers) increase the potential for more individuals to take advantage.

“This deduction is ‘above the line,’ meaning that taxpayers don’t have to itemize to be able to reap the benefit,’” SC&H Group’s Horning said. “They will be able to take a full deduction of the sales tax for cars costing up to $49,500; however, should they buy a more expensive vehicle, they will only be eligible for the deduction up to that amount.’”

Horning believe this provision could have some impact on auto-sales activity as individuals who might be considering a new-car purchase in the next few years could push that decision up to 2009 to take advantage of the deduction.

"It probably doesn't mean people will be buying more cars [overall] than they [otherwise] would have,'" said Horning. "This just moves up the timing of that next potential purchase.'"

Qualified 529 Plans

UHY Advisors' Hickl believes that the expanded definition of qualified higher education expenses may also prove helpful for individuals with 529 plans and children attending college in 2009 and 2010. Under the stimulus package, computers and related technology will qualify as expenses for tax-advantaged savings plans for the next two years.

"I have a son in college now, so we can personally take advantage of this provision,'" Hickl said "Historically, only direct college costs like tuition and housing were 'qualified' expenses. Now, folks can buy their kids computers and use the college-savings account to pay for them. Most of our clients set up 529 plans and we are speaking to all of them with college age children about this potential benefit.'"

Home Energy Credit

The stimulus bill also increases (from 10% to 30%) the eligible credit for energy-efficiency purchases made in the home. SC&H Group's Horning believes that homeowners who have been planning to replace furnaces or water heaters - or to install new energy-efficient doors and windows - should look into such opportunities this year and next.

"For many, these moves make sense even absent the tax credit,'" Horning said. "Such purchases help homeowners to counter higher utility costs and the credit effectively reduces the payback period of the new equipment purchases.'"

Make Work Pay

The single-largest tax provision within the stimulus package is the "Making Work Pay Credit'" that provides a $400 credit ($800 if filing jointly) to employees who make less than $75,000 ($150,000 if filing jointly) in compensation. The estimated cost of the provision is $116 billion over a 10-year period.

Even low-income families who don't make enough income to owe taxes are still eligible for this credit.

Unlike the 2008 Bush tax rebates, which were distributed directly to eligible taxpayers, the government will not be sending any checks this time. Instead, the credit can be claimed on the 2009 tax return or received each pay period through deductions on the employees' paycheck.

Horning points out that the recipients of this credit do not need to take any action in order to participate. In fact, the Internal Revenue Service has issued new withholding tables that employers must begin to use no later than April 1, 2009. The tables are designed to promptly and automatically deliver the benefit of the credit to employees so that these dollars get put back into the economy more quickly. Horning believes that - while the afore-mentioned $116 billion outlay represents a significant cost - the amount per individual, on a case-by-case basis, is not substantial.

Ron Martin, a managing director and tax-department head with the Houston office of UHY Advisors, agrees that the provision will have limited impact on stimulating growth.

“Last year, individuals received $600 or so in the form of a tax rebate and could take that money directly to the Best Buy (BBY) and purchase a new TV,’” Martin said. “This year, they will not receive a lump-sum payment and instead will recognize something like a $10 windfall on each paycheck. Since they will not be receiving a significant amount of actual cash in hand, this provision, most likely, will not provide much stimulus.’”

The government will be providing a one-time payment of $250 to non-working individuals: retirees, disabled individuals, as well as recipients of Supplemental Security Income (SSI), railroad retirement and certain veteran benefits. SC&H Group’s Horning believes it will be hard to pinpoint how much this will help jump-start the economy, noting that such payments won’t solve major issues or eradicate the challenges many of the recipients already face.

Alternative Minimum Tax

The one provision designed to actually impact upper-middle class and more-high-net-worth taxpayers is the increase in the exemption amount ($70,950) for Alternative Minimum Tax (AMT) calculations. Established in 1969 to close certain loopholes that well-to-do taxpayers were using to reduce their tax liabilities, AMT has begun impacting more middle-income earners because the calculation has not been adjusted for inflation over the years.

SC&H Group’s Horning states that the government has been applying a “patch’” each year in the form of an exemption increase, so the provision in the stimulus bill accounts for nothing more than the enhancement most taxpayers were already expecting.

On a related note, interest on tax-exempt private-activity bonds issued in 2009-2010 will now be excluded from AMT calculations and Horning believes more investors may consider these municipal securities that are issued to fund stadiums, theaters, and other private-user projects.

“Because of the flight-to-quality and dramatic increase in demand for [U.S.] Treasuries, related yields have declined so much and investors may begin seeing some significant opportunities in other fixed-income securities,’” Horning said. “While private-activity bonds may find a new class of investor for the next few years - due to the AMT exclusion

- I believe that general obligation bonds and revenue bonds that are supported by necessities like utilities may be worth a look, as well.'"

Horning also fears that inflation will rear its ugly head in the years to come as the government struggles to raise revenue to retire the newly issued debt. He believes that Treasury Inflated Protected Securities, or TIPS, commodities, and other hard assets could serve as a hedge against inflation when allocated within the context of a diversified portfolio.

The Obama Budget

UHY Advisors' Martin has been talking to clients more about the recently proposed Obama administration budget than the stimulus package. He sees several moves individuals should be considering now in anticipation of its passage.

"The [Obama] administration has been mindful of the need to get the economy growing again and chose not to override the Bush tax cuts or take other fiscal measures that could hinder any chance of recovery,'" Martin said. It seems that to "recognize the delicate balance between economy, budget, and doing the right thing. The proposed budget is set to take effect in 2011, so we have the opportunity to visit with clients about moves we should be taking over the next two years.'"

UHY Advisors' Hickl claims it is not a shocking revelation that taxes will increase on the highest-income earners and is mindful of ways to accelerate his clients' income levels and other revenue streams into 2009 and 2010, particularly for individuals like athletes with long-term contracts [that include] deferred compensation.

Within the proposed budget, Hickl sees the provision to cap mortgage-interest deductibility at 28% as bad policy.

"Limiting this deduction is actually a disguised income tax increase, in my opinion,'" Hickl said. "Say an individual has a $1 million loan at a 7% interest rate. The difference between a deduction at the 35% tax rate and one at 28% is $4,900 in additional taxes due. And that is quite a significant amount.'"

According to SC&H Group's Horning, some homeowners with cash in hand may choose to pay down their mortgages before 2011, particularly as their investments are declining.

UHY Advisors' Martin also mentions the proposed change on charitable deductions as an area his clients should focus on prior to 2011. Like the mortgage interest deductions, under the Obama budget, individuals will only be able to deduct 28% of their qualified donations as opposed to the 35% allowed today.

Since high-income earners make the majority of these contributions, Martin anticipates that charities will be hurt and face a reduction on donations in the years to come. He does see some ways that careful planning can help alleviate the burden on charities.

“If taxpayers have multi-year commitments through something like capital campaigns, they may consider taking the opportunity to accelerate funding of that commitment to make sure they remain fully deductible before the new rules come into play,’” Martin said. “Such a move could serve as win-win as the donor gets the full tax advantage of the deduction, while the charity gets its money sooner and can begin putting the much-needed funds to good use.’”

[**Editor's Note**: Ron Brounes, CPA, is a regular contributor to ***Money Morning***. A technical financial writer, Brounes, is president of **Brounes & Associates,** a Houston, Tex.-based consulting firm that provides writing, communications, and educational services for financial services professionals. Back in January, Brounes wrote about the U.S. mergers-and-acquisitions market as part of "Outlook 2009,'" ***Money Morning***'s popular yearly economy forecasting series.