TaxTips

Keeping you informed...

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First-time Homebuyer Credit

You don't necessarily have to be a first-timer to qualify

President Bush signed the Housing Assistance Act of 2008 this past summer. It allows first-time homebuyers a tax credit equal to the lesser of $7,500 ($3,750 if married filing separately) or ten percent of the purchase price of a home. A "first-time homebuyer" is an individual who had no present ownership interest in a principal residence for the three years preceding the purchase of the new home. If the individual is married, his or her spouse must also meet the definition of a first-time homebuyer.

Sound too good to be true? You're right. The credit must be paid back over fifteen years beginning with the second tax year in which the residence is purchased. In essence, the credit is really a $7,500 interest-free loan from the government. Also, the credit is phased out for taxpayers with modified adjusted gross income between $75,000 and $95,000 ($150,000 and $170,000 for joint filers). Please note that purchases from a related party will not qualify for the credit.

This credit is available for houses purchased after April 8, 2008, and before July 1, 2009.

New Deduction for Non-itemizers

Get the most for your property taxes

For 2008, a "real property tax deduction" is added to the components of the standard deduction. In addition to the standard deduction allowed to non-itemizers, taxpayers are allowed to deduct up to an additional $500 ($1,000 for joint filers) of property taxes paid. Foreign property taxes do not appear to qualify for this deduction; however, they still qualify for itemized deductions.

Selling a Converted Principal Residence

Excluding the gain isn't so easy anymore

Under current law, if you sell property that has been owned and used as a principal residence for two out of the past five years, you can exclude up to $250,000 ($500,000 for joint filers) of the gain. This means you could buy a rental home or rental property and use it as such for years. As long as you moved into it and lived there for two years prior to a sale, you could exclude gain on it (except for depreciation).

Under the Housing Assistance Act of 2008, as of January 1, 2009, the gain allocated to this period of nonqualified use will no longer be excludable. Hence, if you have property used as a second home (e.g., vacation home) or in a rental activity that you some day plan on converting to your principal residence, you may be affected by this new provision. To avoid these new rules altogether, you can sell the property before January 1, 2009. These new rules are very complex, so it's important to talk to your tax professional before converting or selling. It could make a big difference on your tax return.

Early Pension Distributions

How much does it really cost?

Generally, retirement funds aren't taxed until you receive distributions. If you draw on your pension before age 59½, a ten-percent penalty for early withdrawal may apply. In addition, the state you live in may assess an additional tax on the early withdrawal. Some financial institutions have their own charge for not leaving the money with them for long enough. Plus, you must include the full amount of the distribution in your income. In some cases, those who withdraw money early lose almost 50 percent of the amount in tax and penalties. Payors are required to withhold 20 percent of the amount withdrawn for federal income tax. There are a few exceptions to the early withdrawal rule for such things as disability or death. A job lay-off is not an exception, however.

If you will be receiving money from your pension or retirement plan, visit with your tax professional first. There may be a way to minimize, defer, or even avoid paying taxes or penalties.

Repayments of Amounts Previously Included in Income

You may be allowed a deduction

Often taxpayers properly include wages, disability benefits, or other income on their tax return only to find out later that they did not have an unrestricted right to the income. If this happens to you, you'll have to repay the income, usually in a later year. The IRS will allow a deduction or a tax credit, depending on how much you paid back during the tax year.

If the repayment was $3,000 or less, the amount is generally deducted as a miscellaneous itemized deduction on Schedule A, Itemized Deductions. The total of all miscellaneous itemized deductions must exceed two-percent of your total adjusted gross income before any tax benefit is derived.

If the repayment was more than $3,000, you have two choices. You can either deduct the total amount you repaid as a miscellaneous itemized deduction not subject to the two-percent limit, or you may choose a tax credit for the year of repayment equal to the difference in the tax you paid on the income and the amount you would have paid if the income was not included on your tax return in the prior year.

Miscellaneous Itemized Deductions

Did you incur any of these often overlooked deductions?

Miscellaneous itemized deductions are often the most difficult to remember at tax time. Plus, in most cases, only your miscellaneous deductions that exceed two percent of your adjusted gross income are deductible. Did you incur any of the following expenses in 2008?

- Depreciation on a self-owned computer or cell phone required to do your job.
- Dues to chambers of commerce, professional societies, and unions.
- Education that is employment-related.
- Home office or part of your home used regularly and exclusively in your work.
- Job-search expenses in your present occupation.
- Legal fees related to doing or keeping your job, and protecting or collecting taxable income.
- Licenses and regulatory fees, as well as occupational taxes.
- Malpractice insurance premiums.
- Medical examinations required by an employer.
- Passport for a business trip.
- Subscriptions to professional journals and trade magazines related to your work.
- Tools, supplies, and safety equipment used in your work.
- Travel, transportation, entertainment, and gift expenses related to your work.
- Work clothes and uniforms and their upkeep costs.
- Tax preparation fees.
- Safe deposit box.

If you incurred any of these expenses, be sure to notify your tax professional so he or she can determine if they are deductible. Once you get past the two-percent limit, these deductions can really add up!

Payments You Receive From a Settlement Are Taxable

Unless they're a result of injury or sickness

Settlements resulting from a lawsuit can arise for a number of reasons. Since August 21, 1996, all damage awards, including punitive damages, are included in taxable income unless the award was due to personal physical injury or physical sickness. Damage awards can also be paid as a result of injury to a capital asset. For example, a car careens into your home and causes damage to the structure. You sue the driver and are awarded a settlement. The amount you receive is only taxable if it exceeds the basis in your home. If that's the case, the excess is reported as a capital gain. In any event, the amount you receive will reduce the basis of your home.

If you receive a lawsuit settlement, be sure to bring the details of the settlement to your tax preparer so he or she can determine how much, if any, of the proceeds are taxable.

QUIK TIPS

1 Your cost basis in mutual fund shares includes reinvested dividends.

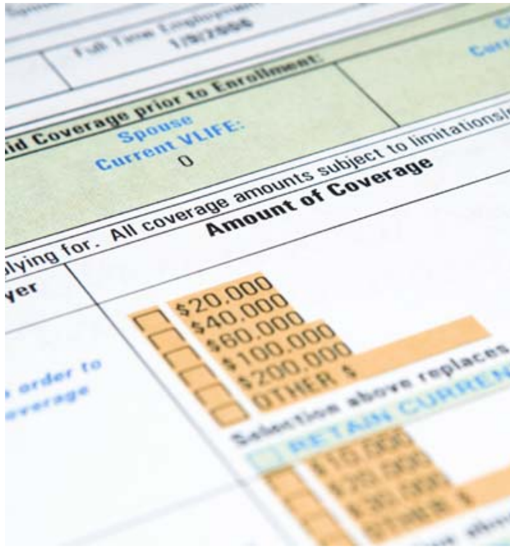
2 Don't forget to provide your tax preparer with a log of your business, medical, and charitable miles. Following are the 2008 standard mileage rates:

- 50.5 cents per mile for business (January 1 – June 30, 2008)
- 58.5 cents per mile for business (July 1 – December 31, 2008)
- 19 cents per mile for medical
- 14 cents per mile for charitable

3 If you receive a notice from the IRS, don't assume that it's correct and automatically pay the amount shown on the notice. Many IRS notices just require you to give the IRS additional information to show why you do not owe the additional taxes or penalties. Always consult with your tax preparer when you receive notices from the IRS.

4 The costs for weight-loss programs can be deducted as a medical expense if the taxpayer is diagnosed by a physician as obese or suffers from some other ailments, such as hypertension, where weight loss would relieve the medical condition. However, the cost of any food is not deductible.

5 Go to your tax appointment well organized. Have all your income statements such as W-2s and 1099s separate from your expenses. Make sure you have all the proper social security numbers for dependents, as well as their names as they appear on their social security cards. Careful organization will save you time come tax season.



Who Needs Life Insurance?

Chances are you do

No one likes to think of their own death, and the thought of paying for life insurance doesn't make the thought any more palatable. The truth is, life insurance is protection for those you leave behind—your family.

If you are young and in good health, life insurance premiums are generally less expensive than they will be later in life. For this reason, your insurance agent or financial planner may encourage you to invest in life insurance early.

There are two basic types of life insurance: term life insurance, where you choose the coverage amount and length of the policy, and whole or permanent life insurance, which combines an investment product with life insurance.

Term life insurance is good for short-term needs. Two good examples of this are to cover your children's college education and to cover your mortgage. Parents could buy a policy that expires after their children graduate from college to ensure that the full education is paid for in the event that something happens to the parents. Or, the main breadwinner in a house could buy a term policy that matches the length of his or her home's mortgage.

Under a whole life policy, of which there are many variations, you agree to pay regular premiums in exchange for a guarantee of a specified benefit payable to your spouse or other beneficiaries upon your death. Earnings on a whole life policy are set by the insurance company based on the overall return on its investments. Earnings above and beyond those required to cover the death benefit will go to the policy's cash reserve, which you can borrow against, withdraw, use to pay premiums, or accumulate for long-term goals such as retirement. Premiums for whole life or permanent insurance are generally higher than a term policy.

If you do not currently have a life insurance policy, don't wait. Even though life insurance premiums are not tax deductible, the long-term benefits are significant.

Adoption Expenses

Have you expanded your family?

If you are thinking about, or have already adopted a child under the age of 18, there are deductions and credits available for the expenses you have incurred. A recent change to the law has increased the amount of credit that is available. In 2008, you may be entitled to a tax credit of up to $11,650.

Expenses that qualify for this credit include any reasonable and necessary adoption fee, court costs, attorney fees, travel expenses (including meals and lodging), and any other expenses you paid that were required by the state as a condition of the adoption.

Generally, the credit is allowed in the year the adoption becomes final. If you paid adoption expenses in 2007, and the adoption is not final until 2008, the credit will be allowed on your 2008 income tax return. If you adopt a special needs child from the U.S., you are eligible for the full $11,650 credit regardless of your actual expenses.

The credit will reduce your tax liability dollar for dollar. If you are unable to use the entire amount, the remainder can be carried over to claim for the next five years. Any carryover existing after the five-year period is lost.

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.