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The Recovery Act and its impact on business.

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The American Recovery and Reinvestment Act of 2009

The Impact on Individuals:

The American Recovery and Reinvestment Act of 2009 (commonly referred to as the Recovery Act), which was signed into law on February 17, 2009, makes a number of beneficial tax changes for individuals. However, most of them are temporary in nature, that is, unless extended by future legislation, they apply for 2009 only or in some cases for 2009 and 2010. Here's a review of the more widely applicable provisions that could have an impact on you and your family.

New Making Work Pay Credit. Individuals who work generally get a credit of up to $400 ($800 for joint filers). The credit is refundable, meaning you get it even if you owe no income tax. This change applies for 2009 and 2010. The credit is the lesser of 6.2% of your earned income or $400 ($800 on a joint return). The credit is phased out for joint filers with modified adjusted gross income between $150,000 and $190,000 and other taxpayers with modified AGI between $75,000 and $95,000.

You won't be getting a separate check from the IRS, as you did with last year's Stimulus payment. Rather, your employer will automatically adjust your withholding so that you will get a little more money in each paycheck.

One-time $250 payment or credit for others. The Recovery Act provides a one-time payment of $250 in 2009 to retirees, disabled individuals and SSI recipients receiving benefits from the Social Security Administration, Railroad Retirement beneficiaries and disabled veterans receiving benefits from the U.S. Department of Veterans Affairs. It also provides a one-time refundable tax credit of $250 in 2009 to certain government retirees who are not eligible for Social Security benefits. The Making Work Pay credit is reduced by any $250 payment or credit received.

New sales tax deduction for vehicle purchases. For 2009, there is a new deduction for state and local sales and excise taxes paid on the purchase of new cars, light trucks, motor homes and motorcycles after February 16, 2009 and before January 1, 2010. The deduction generally is available regardless of whether you itemize deductions on Schedule A or claim the standard deduction.

The deduction is limited to the tax on up to $49,500 of the purchase price of an eligible motor vehicle.

The deduction is phased out for joint filers with modified adjusted gross income between $250,000 and $260,000 and other taxpayers with modified AGI between $125,000 and $135,000.

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Cover Story:

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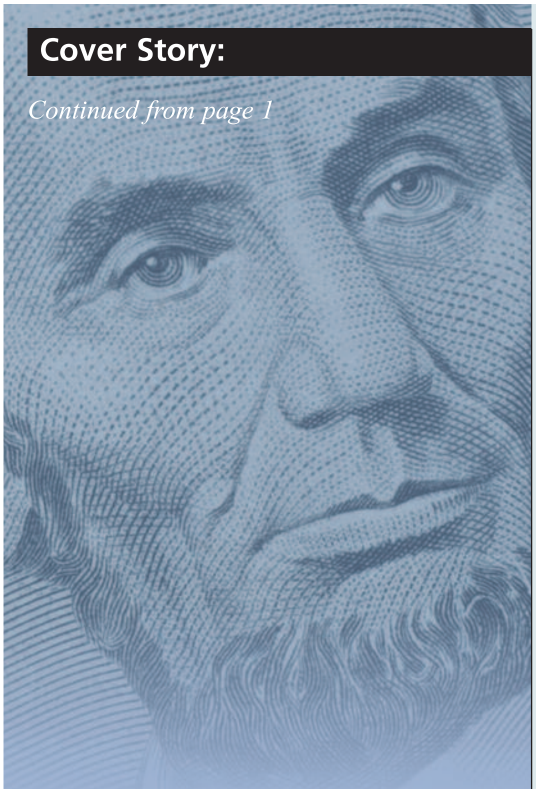

If you itemize and choose the option to deduct state sales taxes in lieu of state income taxes, you don't get the new deduction. This prevents you from getting a double deduction for the sales taxes on the vehicle but it also involves some tricky planning considerations because different rules apply to the optional deduction and the new deduction. For example, the new deduction, but not the optional deduction, is allowed against the alternative minimum tax. Additionally, the optional deduction is subject to a limitation that caps the deduction for sales tax on a motor vehicle to the general sales tax rate.

Improved first-time homebuyer credit. Last year's Housing Act included a refundable tax credit for first-time homebuyers equal to the lesser of 10% of the purchase price or $7,500 for qualifying purchases after April 1, 2008 and before July 1, 2009. The credit is essentially an interest-free loan because it has to be paid back to the government over 15 years.

The Recovery Act has improved the credit for 2009 purchases by (1) eliminating the requirement to pay it back (subject to exceptions), (2) increasing the maximum credit to $8,000 and (3) making it available for purchases through November 2009.

You can treat a 2009 purchase as having been made on December 31, 2008 and thus get an immediate refund when you file your 2008 taxes by the April 15, 2009 filing deadline. Even if you have already filed your 2008 taxes, you can file an amended 2008 return to get the credit for a 2009 purchase.

You are considered a first-time homebuyer if you (or your spouse, if married) had no present ownership interest in a principal residence in the U.S. during the 3-year period before the purchase of the home to which the credit applies.

The first-time homebuyer credit, whether claimed in 2008 or 2009, phases out for individual taxpayers with modified adjusted gross income between $75,000 and $95,000 ($150,000–$170,000 for joint filers).

AMT relief. The Recovery Act provides AMT relief for 2009 by (1) increasing the exemption amounts above last year's levels and (2) allowing nonrefundable credits to offset AMT as well as regular tax.

College tax breaks. The Recovery Act expands tax breaks for individuals seeking a college education. For 2009 and 2010, it gives taxpayers a new "American Opportunity" tax credit of up to $2,500 of the cost of tuition and related expenses paid during the tax year. You 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. Forty percent of the credit is refundable. The credit is phased out for taxpayers with modified AGI between $80,000 and $90,000 ($160,000 and $180,000 for joint filers).

Section 529 Education Plans are tax-advantaged savings plans that can be used to pay qualified education expenses, including: tuition, room & board, mandatory fees and books. Under the Recovery Act, for 2009 and 2010, qualified education expenses under these plans include computer technology and equipment as well as Internet access and related services.

Tax break for the unemployed. Unemployment compensation benefits ordinarily are fully taxable. However, under the Recovery Act, an individual does not have to pay tax on up to $2,400 in unemployment benefits received in 2009.

Limited subsidy for COBRA continuation coverage of unemployed workers. The Recovery Act provides a 65% subsidy for COBRA continuation premiums for up to 9 months for workers who have been involuntarily terminated, and for their families. This subsidy also applies to healthcare continuation coverage if required by states for small employers. To qualify for premium assistance, a worker must be involuntarily terminated between September 1, 2008 and December 31, 2009. Workers who were involuntarily terminated between September 1, 2008 and February 17, 2009, but failed to initially elect COBRA because it was unaffordable, must be given an additional 60 days to elect COBRA and receive the subsidy. The subsidy is not taxable when received, but higher income recipients—those with modified adjusted gross income above $125,000 ($250,000 for joint filers)—will have to pay back part or all of it at tax return time.

The impact on individuals at a glance:

- New Making Work Pay Credit
- One-time $250 payment or credit for others
- New sales tax deduction for vehicle purchases
- Improved first-time homebuyer credit
- AMT relief
- College tax breaks
- Tax break for the unemployed
- Limited subsidy for COBRA continuation coverage of unemployed workers
- Refundable child credit expanded
- Bigger earned income tax credit (EITC)
- Increased transit and vanpool transportation fringe benefits
- Improved energy tax breaks

Refundable child credit expanded. A taxpayer receives a $1,000 tax credit for each qualifying child under the age of 17. Before the Recovery Act, this credit was refundable only to a limited extent. The Recovery Act makes the child credit refundable to a much greater extent for 2009 and 2010.

Bigger earned income tax credit (EITC). The Recovery Act makes various changes to the earned income tax credit for 2009 and 2010. These changes will result in a bigger EITC for some taxpayers. For example, in 2009, taxpayers with three or more qualifying children may claim a credit of 45% of earnings up to $12,570 resulting in a maximum credit of $5,656.50.

Increased transit and vanpool transportation fringe benefits. For months beginning on or after March 1, 2009 and before January 1, 2011, the Recovery Act increases the monthly exclusion for employer-provided transit and vanpool benefits from $120 to $230. This figure is adjusted for inflation each year and could go up in 2010.

Improved energy tax breaks. The Recovery Act includes a number of provisions that are designed to promote the creation and use of alternative forms of energy including these new or improved energy tax breaks for individuals:

- The Recovery Act extends the tax credit for energy-efficient improvements to existing homes through 2010 and modifies it in various ways so that a larger credit is possible after 2008.
- Under pre-Recovery Act law, individuals could claim a 30% tax credit for qualified solar water heating property (capped at $2,000), qualified small wind energy property (capped at $500 per kilowatt of capacity, up to $4,000) and qualified geothermal heat pumps (capped at $2,000). For tax years beginning after 2008, the Recovery Act removes these individual dollar caps. As a result, each of these types of improvements is eligible for an uncapped 30% credit.
- The Recovery Act modifies and increases the existing new qualified plug-in electric drive vehicle credit.
- For vehicles bought after February 17, 2009 and before January 1, 2012, the Recovery Act creates a new 10% nonrefundable personal credit for electric drive low-speed vehicles, motorcycles and three-wheeled vehicles.
- For property placed in service after February 17, 2009 and before January 1, 2012, the Recovery Act creates a new 10% credit, up to $4,000, for the cost of converting any motor vehicle into a qualified plug-in electric drive motor vehicle.

The Impact on Businesses:

Here's a review of the more widely applicable provisions that could have an impact on you and your enterprise.

Liberal expensing limits continued for another year. The Recovery Act gave a one-year lease on life to enhanced expensing rules, which allow qualifying businesses the option to currently deduct the cost of business machinery and equipment, instead of recovering its cost via depreciation over a number of years. For tax years beginning in 2009, the maximum amount that a business may expense is $250,000, and the expensing election begins to phase out when a business buys more than $800,000 of expensing-eligible assets. These dollar limits are the same as those that were in effect for 2008. Had the Recovery Act not been passed and signed into law, these dollar limits would have dropped this year to $133,000 and $530,000 respectively.

Bonus first year depreciation extended for another year, too. Bonus depreciation was supposed to go off the books for most assets placed in service after 2008. Fortunately, the Recovery Act extends for another year the ability for businesses to take an extra "bonus" depreciation deduction for the first year new assets are placed in service. The bonus first-year depreciation deduction generally equals 50% of the cost of qualified property (most types of tangible property other than buildings and their structural components, improvements to certain types of leased property and most software) acquired and placed in service during 2009. Certain types of property with a long life and certain types of aircraft may be placed in service before January 1, 2011, and still qualify for the 50% bonus first year depreciation allowance. Also, note that the otherwise allowable first-year depreciation deduction for business autos first placed in service in 2009 is hiked by $8,000 thanks to the Recovery Act.

Extended election to speed up recognition of accumulated AMT and R&D credits instead of claiming bonus depreciation. Many corporations are struggling and can't make good use of the bonus depreciation break. A law enacted last year gave such corporations an alternative tax break. For tax years ending after March 31, 2008, corporations otherwise eligible for bonus depreciation for qualifying assets placed in service in 2008 (or 2009 for certain longer lived assets) could instead elect to accelerate recognition of part of their accumulated pre-2006 research tax credits or certain alternative minimum tax credits. The Recovery Act extends this election so that it is available for property placed in service in 2009 (or 2010 for certain longer lived assets). *Please note that this alternative choice is highly specialized and requires a detailed analysis of a corporation's tax situation.*

Deferred tax on debt forgiveness income when debt is repurchased. A business generally will wind up with debt discharge income if it repurchases its debt for less than the outstanding amount of the debt. For debt that's repurchased in 2009 or 2010, the Recovery Act permits the tax that's owed on such debt discharge income to be paid over five years, beginning with 2014.

Small businesses may elect longer NOL carry back period. In general, net operating losses (NOLs) may be carried back two years and forward 20 years (different rules apply for certain specialized types of losses). For NOLs arising in a tax year beginning or ending in 2008, the Recovery Act permits small businesses to elect to increase the NOL carryback period from two years to three, four or five years. A small business for this purpose is a trade or business (including one conducted in or through a corporation, partnership or sole proprietorship) whose average annual gross receipts are $15 million or less for the three-tax-year period (or shorter period of existence)

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The Impact on Businesses…

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ending with the tax year before the year in which the loss arose. The longer NOL carryback period gives small businesses that experienced losses the ability to get refunds of income taxes paid in earlier years. The refunds can be used to fund capital investment or other expenses.

S corporation built-in gain holding period shortened temporarily. An S corporation generally is not subject to tax; instead, it passes through its income or loss items to its shareholders, who pay tax on their pro-rata shares of the S corporation's income. However, if a business that was formed as a C corporation elects to become an S corporation, the S corporation is taxed at the highest corporate rate (currently 35%) on all gains that were "built-in" at the time of the election if the gains are recognized during a special holding period. This holding period is the first ten S corporation years. (Similar rules apply if an S corporation receives property from a C corporation in certain nontaxable transfers.) Thanks to the Recovery Act, for tax years beginning in 2009 and 2010, the special holding period is shortened to seven years.

Bigger exclusion for sale of qualified small business stock. Before the Recovery Act, individuals could exclude 50% of their gain on the sale of qualified small business stock (QSBS) held for at least five years (60% for certain empowerment zone businesses). To qualify, QSBS must meet a number of conditions (e.g., its gross assets can't exceed $50 million and it must meet active business requirements). Under the Recovery Act, the percentage exclusion for gain on QSBS sold by an individual increases to 75% for stock acquired after February 17, 2009 and before January 1, 2011.

Reduced estimated taxes in 2009 for individuals with small businesses. To the extent that tax isn't collected through withholding, individuals generally must make quarterly estimated payments of the "required annual payment." The required annual payment is the lesser of: (1) 90% of the tax shown on the return or (2) 100% of the tax shown on the preceding year's return (110% if adjusted gross income (AGI) for the preceding year exceeded $150,000). The Recovery Act provides that for a tax year beginning in 2009, the required annual payment for individuals with small businesses is the lesser of (1) 90% of the tax shown on the return for the tax year or (2) 90% of the tax shown for the preceding tax year. An individual qualifies for this relaxed estimated tax payment rule only if: AGI on preceding year's return is less than $500,000 ($250,000 if married filing separately); and at least 50% of the gross income shown on the previous year's return was from a small trade or business (one that employed no more than 500 people, on average, during the calendar year ending in or with the preceding tax year).

More workers eligible for work opportunity tax credit (WOTC). Employers that hire workers from one or more targeted groups (e.g., long-term family assistance recipients) can claim a tax credit that varies with the type of person hired. For individuals beginning work for the employer after December 31, 2008, the Recovery Act creates a new targeted group for the WOTC, consisting of unemployed veterans and disconnected youth who begin work for the employer in 2009 or 2010.

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