

# Tax Compliance & Planning TRENDS

## President Obama's \$800 billion Stimulus Act Provides Tax Relief for Businesses & Individuals

*The American Recovery and Reinvestment Act of 2009 (ARRA) was signed into law on February 17. While approximately two-thirds of the nearly \$800 billion stimulus act is focused on government spending initiatives intended to create jobs and jumpstart the economy, about one-third provides tax breaks for businesses and individuals.*

### For Businesses

#### New Tax Breaks

- **Reduced Estimated Tax Payment Requirements**

For 2009, ARRA reduces the estimated tax payment requirements for many small business owners. Owners generally will qualify for the reduced payments if their Adjusted Gross Income (AGI) for 2008 was less than \$500,000 and if more than 50% of their 2009 gross income is generated from a "small business," which is defined as a business that, on average, had fewer than 500 employees during 2008.

- **Deferral of Income from Cancellation of Debt**

Taxpayers generally must recognize cancellation-of-debt income (CODI) when they cancel — or repurchase — debt for an amount less than its adjusted issue price. In certain situations, ARRA allows businesses to defer CODI generated from repurchasing business debt after Dec. 31, 2008, and before Jan. 1, 2011, until calendar year 2014 and then report the income ratably over the 2014 through 2018 tax years.

- **Built-in Gains Tax Relief for S Corps**

Although a C corporation conversion to an S corporation isn't a taxable event, the S corporation normally must hold on to its assets for 10 years to avoid tax on any built-in gains that existed at the time of the conversion. Under ARRA, for tax years beginning in 2009 and 2010, there generally will be no tax on an S corporation's net unrecognized built-in gain if the seventh tax year in the recognition period occurred before the 2009 and 2010 tax years.

#### Expanded Tax Breaks

- **Net Operating Loss Carry-back**

Generally, a net operating loss (NOL) may be carried back two years to generate a current tax refund, providing a cash infusion in times of loss. For 2008 (not 2009), ARRA extends the maximum NOL carryback to five years for qualified small businesses with gross receipts of \$15 million or less.

- **Work Opportunity Credit**

Employers can claim a credit equal to 40% of the first \$6,000 of wages paid to employees in certain target groups, such as ex-felons, food stamp recipients and disabled veterans. ARRA expands the eligible target groups to include unemployed veterans and disconnected youth. This expanded benefit generally applies to such workers hired in 2009 and 2010.

- **Depreciation Breaks Extended**

To spur additional investment, ARRA extends the increase in the Section 179 limit for initial year expensing to \$250,000 (from \$125,000 indexed for inflation). The expensing election begins to phase out dollar for dollar when total asset acquisitions for the tax year exceed \$800,000 (up

from \$500,000 indexed for inflation). The new higher limit applies for calendar year 2009 or a business's fiscal year that begins in 2009.

Another depreciation-related provision extends the special allowance for certain property, generally if acquired in 2009. For eligible property, the special depreciation amount is equal to 50% of its adjusted basis. For passenger automobiles that are eligible property under the 50% bonus depreciation rules, the \$8,000 increase for the first-year limit on depreciation also is extended to new vehicles placed in service in 2009.

Last year, corporate taxpayers were also allowed to accelerate their alternative minimum tax (AMT) and research and development (R&D) credits in lieu of taking the 50% bonus depreciation. That break has now been extended through 2009.

### **Expanded Energy-Related Tax Cuts**

ARRA creates or expands several energy-related breaks for businesses, such as the *advanced energy investment credit*, the *renewable electricity production credit*, and the *Alternative fuel pump tax credit*.

## **For Individuals**

### **New Tax Breaks**

- **Relief for Workers, Retirees & other Social Security Recipients**

For 2009 and 2010, ARRA creates the Making Work Pay credit of up to \$800 for joint filers and \$400 for other filers. The credit generally phases out for joint filers with Adjusted Gross Incomes (AGI) exceeding \$150,000 and for other filers with AGIs exceeding \$75,000. Unlike last year's "recovery rebate," which was distributed via checks mailed to taxpayers, the new credit will generally be "paid" through a reduction in income tax withholding.

The act also provides a one-time payment of \$250 to many people on fixed incomes, such as Social Security recipients and disabled veterans. Similarly, it provides a one-time refundable tax credit of \$250 to certain government retirees who aren't eligible for Social Security benefits. Both the \$250 payment and the \$250 credit reduce any allowable Making Work Pay credit.

- **Sales Tax Deduction for Vehicle Purchases**

ARRA creates a new above-the-line deduction for state and local sales and excise taxes paid on the purchase of new cars, light trucks, motorcycles and recreational vehicles. The deduction is available for vehicles purchased from Feb. 17, 2009, through Dec. 31, 2009.

The deduction is not, however, available for tax attributable to vehicle value in excess of \$49,500. The deduction also phases out based on AGI, but the limits are higher than those for the Making Work Pay credit: The phaseout begins for joint filers with AGIs exceeding \$250,000 and for other filers with AGIs exceeding \$125,000.

### **Expanded Tax Breaks**

- **Credit for First Time Home Buyers**

Last year, a refundable credit equal to 10% of the purchase price of a principal residence was made available to qualified first-time homebuyers. This credit was set to expire July 1, 2009, but ARRA extends its availability to purchases made before Dec. 1, 2009. For qualifying purchases made after Dec. 31, 2008, the act also increases the maximum credit from \$7,500 to \$8,000. Perhaps most significant, the act eliminates the repayment obligation for taxpayers whose qualifying purchase occurs after Dec. 31, 2008 — except in situations where a home is sold within three years of purchase.

- **American Opportunity Education Credit** (previously called the Hope credit)  
 For 2009 and 2010, ARRA expands this credit to cover 100% of the first \$2,000 of tuition and related expenses (including books) and 25% of the next \$2,000 of such expenses. The maximum credit is \$2,500 per year for the first four years of postsecondary education. (The maximum Hope credit was \$1,800 and applied to only the first two years of postsecondary education.) The credit phases out for joint filers with AGIs exceeding \$160,000 and for other filers with AGIs exceeding \$80,000.
- **Section 529 College Savings Plans**  
 529 plan distributions that are used to pay for qualified education expenses — tuition, room, board, mandatory fees and books — are generally tax free. For expenses paid in 2009 and 2010, ARRA expands the definition of qualified education expenses to include computers and computer technology.
- **Qualified Small Business Stock Gain Exclusion**  
 Generally, taxpayers selling Qualified Small Business (QSB) stock are allowed to exclude 50% of their gain as long as they've held the stock for at least five years. ARRA increases the exclusion to 75% if the stock is issued after Feb. 17, 2009, and before Jan. 1, 2011.
- **AMT Relief Granted Early**  
 One tax provision affecting individuals that many thought wouldn't be enacted until later in the year is the extension of Alternative Minimum Tax (AMT) relief. ARRA provides a one-year "patch" that increases the AMT exemption. For married couples filing jointly, the 2009 exemption is \$70,950. For singles and heads of households, it's \$46,700, and for married filing separately, it's \$35,475.

The patch also expands the AMT income ranges over which the exemptions phase out and only partial exemptions are available. The 2009 phase-out ranges are now \$150,000 to \$433,800 for married filing jointly, \$112,500 to \$299,300 for singles and heads of households, and \$75,000 to \$216,900 for married filing separately. The exemption is completely phased out if AMT income exceeds the top of the applicable range.

Additionally, ARRA extends a provision through 2009 that allows certain nonrefundable personal tax credits to provide a benefit against the AMT. These include the dependent care credit, the American Opportunity credit and the Lifetime Learning credit. The act also excludes from the AMT any income from tax-exempt bonds issued in 2009 and 2010, along with 2009 and 2010 refundings of bonds issued after Dec. 31, 2002, and before Jan. 1, 2009.

### **Expanded Energy-Related Tax Cuts**

ARRA creates or expands several energy-related breaks for individuals, such as *transit benefits, the residential energy property credit, the residential energy-efficient property credit and the plug-in electric vehicles credit.*

### **Help for Laid-off Workers**

Although much of ARRA focuses on working Americans, it also provides some tax relief for laid-off workers. For 2009, the act suspends federal income tax on the first \$2,400 of unemployment benefits per recipient.

### **Seniors not Required to Withdraw Retirement Funds**

Retirees retain the option of withdrawing funds from retirement plans if they need the money. However, even before the recent stock market volatility, many preferred to withdraw only the minimum RMD to maximize continued tax-deferred growth. Now, in 2009, they may choose *not* to withdraw any funds from their retirement accounts, and will not be penalized for leaving the money in their accounts.