

American Recovery and Reinvestment Act of 2009

How the tax changes affect you

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (the “Recovery Act”) was signed into law. Below is a summary of some of the provisions that could impact you and your business.

Liberal expensing limits continued for another year.

The Recovery Act extended the rules in effect for 2008. Thus, 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.

Bonus first year depreciation also extended for another year.

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 percent of the cost of qualified property acquired and placed in service at any time 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 percent bonus first year depreciation allowance.

Deferred tax on debt forgiveness income when debt is repurchased.

A business generally will have 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. A business is considered to repurchase its debt if it exchanges such debt for cash, another debt instrument (i.e., modifies the debt), stock, partnership interest or if there is a complete forgiveness by the creditor.

Small businesses may elect longer NOL carryback period.

Generally, net operating losses (NOLs) may be carried back two years and forward 20 years. 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 over a three year period. The longer NOL carryback period gives small businesses that experienced losses the ability to get refunds of income taxes paid in earlier years.

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 on all gains that were "built-in" at the time of the election if the gains are recognized during a special holding period. Pursuant to the Recovery Act, for tax years beginning in 2009 and 2010, the special holding period is shortened to seven years. This new rule applies to corporations that made their s elections in 2002 and 2003.

Bigger exclusion for sale of qualified small business stock.

Before the Recovery Act, individuals could exclude 50 percent of their gain on the sale of qualified small business stock (QSBS) held for at least five years (60 percent for certain empowerment zone businesses). A business must meet certain conditions for its stock to qualify as QSBS (for example, its gross assets can't exceed \$50 million and it must meet active business requirements). Under the Recovery Act, the percentage exclusion for QSBS sold by an individual increases to 75 percent 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, taxpayers generally must make quarterly estimated payments of the "required annual payment." The required annual payment is the lesser of: (1) 90 percent of the tax shown on the return or (2) 100% of the tax shown on the preceding year's return (110 percent 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 is the lesser of (1) 90 percent of the tax shown on the return for the tax year, or (2) 90 percent 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 percent 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 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.

AMT relief.

Generally, to find out if you owe alternative minimum tax (AMT), you start with regular taxable income, modify it with various adjustments and preferences (such as addbacks for property and income tax deductions and dependency exemptions), and then subtract an exemption amount (which phases out at higher levels of income). The result is multiplied by an AMT tax rate of 26 percent or 28 percent to arrive at the tentative minimum tax. You pay the AMT only if the tentative minimum tax exceeds your regular tax bill. Exemption amounts were scheduled to drop and fewer tax credits were to be available to offset AMT for 2009. 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.

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The above summary is a highlight of some of the new key tax provisions. For more information on these provisions, please contact Lark T. Mallory at 614-334-6108 or lmallory@cwslaw.com.