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Stimulus Bill Adds and Extends Numerous Tax Incentives for Both Businesses and Individuals – Short-Term Focus Requires Timely Consideration and Action

The February 17 signing of the American Recovery and Reinvestment Act of 2009 (ARRA) – more commonly known as the second stimulus bill – created a massive package of spending and tax incentives making more than 300 changes to the Internal Revenue Code. Those changes include significant tax breaks intended to help businesses create jobs and boost the economy as well as a number of incentives for individuals. Many changes are temporary, intended to last only one or two years in an effort to jump-start the economy, so businesses who can benefit must take action quickly.

This alert provides an overview of the most significant aspects of the bill for businesses; for additional information, please contact your AGH tax professional at (316) 267-7231.

Business Highlights:

Section 179 higher expensing limits and ceiling extended: For eligible property, taxpayers may choose to expense the cost of purchasing an asset, rather than taking depreciation deductions over a period of years. Before 2008, the total that could be expensed for eligible property was $125,000; the 2008 stimulus act increased that limit to $250,000 and added a "ceiling" of $800,000. The ceiling's effect is that if the business purchased eligible assets of up to $800,000 total within the year, the full $250,000 could be expensed – but the purchase of assets totaling more than $800,000 ceiling reduced the $250,000 expensing limit dollar-for-dollar. *(For example, if a business purchases $825,000 of eligible property, it has exceeded the investment ceiling of $800,000 by $25,000. The company may only expense $225,000 of its purchases because the $250,000 expensing allowance was reduced by $25,000 – the amount total asset purchases exceeded the $800,000 ceiling.)*

For 2009, ARRA retains the higher annual expensing limit of $250,000 and investment ceiling of $800,000. These limits are for 2009 only; unless further amended, the limits fall to $125,000 with a $500,000 ceiling in 2010 and $25,000 with a $200,000 ceiling in 2011.

Businesses purchasing assets for which Section 179 expensing applies may also be able to use bonus depreciation; the two incentives work together, but Section 179 expensing comes "off the top" before bonus depreciation is figured.

Bonus depreciation extended in 2009: Most property is depreciated over a period of time based on the type of asset. Last year's Economic Stimulus Act allowed businesses to take an additional depreciation deduction of 50% of the eligible assets' adjusted cost if the assets were placed in service in 2008. This "bonus depreciation" has been extended into 2009, allowing the additional 50% depreciation deduction for qualified property purchased and placed into service before January 1, 2010 (before January 1, 2011 for certain longer-lived properties). Most types of property other than buildings qualify for this bonus depreciation.

Net operating loss carry back period lengthened: Pre-ARRA, "small businesses" with more business deductions than gross income during a year could apply ("carry back") those deductions to up to two previous tax years, potentially generating a refund at a time the business is likely to need cash. The ARRA increases the number of prior tax years to which the deductions may be applied from two to five.

"Small business" in this situation is defined as a business with annual gross receipts of less than $15 million annually.

Lower estimated tax payments: “Small businesses” have been required to make quarterly estimated tax payments based on a required annual payment, which is figured as a percentage of the previous year’s tax paid. The percentage has been lowered from 100% of the previous year’s tax return to 90%. 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 December 31, 2008, and before January 1, 2011, until calendar year 2014 and then report the income ratably over the 2014 through 2018 tax years.

S corporation built-in gains tax relief. 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.

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.

R&D credits extended: 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.

Energy-related breaks for businesses expanded: ARRA creates or expands several energy-related breaks for businesses, such as the advanced energy investment credit, renewable electricity production credit, and alternative fuel pump tax credit. If your business plans to use or invest in alternative energy, ask your AGH tax advisor for more details.

Highlights for individual taxpayers

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 February 17, 2009, and before January 1, 2011.

AMT relief granted early this year: 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 December 31, 2002, and before January 1, 2009.

New 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 February 17, 2009, through December 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 phase-out begins for joint filers with AGIs exceeding $250,000 and for other filers with AGIs exceeding $125,000.

529 savings plans: 529 plan distributions used to pay 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.

New relief for most workers, retirees and 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 AGIs 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.

Credit for first-time homebuyers: 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 December 1, 2009. For qualifying purchases made after December 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 December 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.

Energy-related breaks expanded for individuals: ARRA creates or expands several energy-related breaks for individuals, such as:

- Transit benefits,
- Residential energy property credit,
- Residential energy-efficient property credit, and
- Plug-in electric vehicles credit.

Help given to 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.

Energy incentives: ARRA creates or expands several energy-related breaks for individuals as well, including transit benefits, residential energy property credit, residential energy-efficient property credit and plug-in electric vehicles credit.

The bill's massive scope affects many businesses and individuals; for information specific to your situation, please contact your AGH advisor to determine how best to respond and where you may be able to benefit.