2009

TAX LAW STIMULUS

American Recovery & Reinvestment Tax Act of 2009

REYNOLDS
BONE &
GRIESBECK PLC
CERTIFIED PUBLIC ACCOUNTANTS & ADVISORS

The deepest recession in recent memory has led Congress and the new Administration to put in place a comprehensive economic stimulus plan. Part of that plan is the American Recovery and Reinvestment Tax Act of 2009 (the "2009 Act"), which provides a measure of federal tax relief to most individuals and businesses. The new law will put dollars into the hands of taxpayers — dollars that our lawmakers hope will be spent in ways to stimulate the economy and create jobs.

This booklet summarizes the major provisions of the 2009 Act. Many of the new rules are complicated, and most are temporary. We urge you to seek professional assistance before acting on anything you read in this summary. The new law presents important planning opportunities for many taxpayers, and a professional can help you best take advantage of them.

Tax Benefits for Individuals

"Making Work Pay" Tax Credit

One objective of the 2009 Act is to get money into the hands of individual taxpayers as quickly as possible. To this end, the new law creates a refundable income-tax credit of up to $400 for eligible single filers and $800 for eligible couples filing a joint tax return. (A credit is a dollar-for-dollar offset against tax; a refundable credit is one for which the tax law allows a refund of the unused credit when tax liabilities are not high enough to take full advantage of the credit.)

The Making Work Pay credit may be claimed *either* as a reduction in the federal income tax that is withheld from a worker's paycheck *or* through a credit claimed on the taxpayer's income-tax return. Most eligible individuals will be able to realize this tax benefit through a reduction in withheld income taxes and, thus, a higher take-home pay. Individuals who may be claimed as dependents and nonresident aliens are not eligible.

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The credit is calculated at a rate of 6.2% of earned income, up to the $400/$800 credit maximum. The credit begins to be phased out when annual modified adjusted gross income (AGI) exceeds $75,000 ($150,000 for married persons filing jointly) at a rate of 2% of the excess over the $75,000/$150,000 amounts. The credit is fully phased out when modified AGI reaches $95,000 ($190,000 for joint filers).

> ***Example:*** Marge and Homer have a joint modified AGI of $160,000 in 2009. Their Making Work Pay tax credit would be $600 — i.e., $800 reduced by a phaseout amount of $200 ($160,000 – $150,000 = $10,000; $10,000 × 2% = $200).

The Making Work Pay tax credit is in effect for tax years beginning in 2009 and 2010.

Economic Recovery Payment

The 2009 Act provides a one-time economic recovery payment of $250 to adults who are eligible for Social Security benefits, Railroad Retirement benefits, veterans' disability compensation or pension benefits, or qualifying individuals who are eligible for Supplemental Security Income (SSI) benefits. Only individuals who were eligible for one of the four programs for any of the three months prior to the month of the new law's enactment will receive an economic recovery payment.

An individual shall receive only one $250 economic recovery payment regardless of whether the individual is eligible for a benefit from more than one of the four federal programs. If the individual is also eligible for the Making Work Pay credit, that credit will be reduced by any economic recovery payment made.

The 2009 Act also provides for a one-time refundable tax credit of $250 in 2009 to certain government retirees who are not eligible for Social Security benefits. The credit is $500 on a joint return if both spouses are eligible. This credit also is a reduction to any allowable Making Work Pay credit.

First-time Homebuyer Credit

Pre-2009 Act tax law allows a first-time homebuyer a refundable tax credit equal to the lesser of $7,500 ($3,750 for a married individual filing separately) or 10% of the purchase price of a principal residence. A taxpayer is considered a first-time homebuyer if the taxpayer had no ownership interest in a principal residence in the U.S. during the three-year period prior to the purchase.

The credit is allowed for qualifying home purchases on or after April 9, 2008, and before July 1, 2009. The credit phases out for individual taxpayers with modified AGI between $75,000 and $95,000 ($150,000 and $170,000 for joint filers) for the year of purchase. The credit is generally allowed for the tax year in which the taxpayer purchases the home.

Under pre-2009 Act law, the new homebuyer credit generally was to be paid back to the government ratably over 15 years with no interest charge, beginning in the second tax year after the tax year in which the home is purchased. In effect, the credit was a no-interest loan.

Under the 2009 Act, the maximum credit amount is increased to $8,000 ($4,000 for married persons filing separately) and the credit is extended so that it applies to purchases made prior to December 1, 2009. In addition, for homes bought after December 31, 2008, and before December 1, 2009, the credit does not have to be repaid unless the home is resold or otherwise ceases to be the taxpayer's principal residence within 36 months of purchase.

AMT Exemption Increase

The alternative minimum tax (AMT) is designed to ensure that individuals who have high incomes and significant income-tax deductions or credits pay a minimum amount of tax. The tax law provides each taxpayer an AMT exemption, which phases out at higher income levels. However, those exemption amounts are not tied to inflation. As a result, many middle-income taxpayers find themselves being hit with AMT.

Over the past decade, Congress has passed temporary increases in the AMT exemptions to reduce the number of middle-income taxpayers who have to pay AMT. The latest increase expired at the end of 2008. For 2009, the exemptions were to decrease to the exemption amounts in place before the temporary increases were implemented.

The 2009 Act extends the higher AMT exemption amounts to taxable years starting in 2009 and increases them for 2009. In addition, taxpayers may use various nonrefundable tax credits to offset regular tax and AMT.

AMT Exemption Amounts			
Type of Filer	**2008 Amounts**	**Pre-Act 2009 Amounts**	**Post-Act 2009 Amounts**
Married filing jointly	$69,950	$45,000	$70,950
Unmarried	$46,200	$33,750	$46,700
Married filing separately	$34,975	$22,500	$35,475

Private Activity Bond Interest and AMT

In general, tax-exempt interest on so-called "private activity" municipal bonds (e.g., those used to fund private sector projects) is included as a tax preference for AMT purposes. Thus, interest that is tax exempt for regular tax purposes is taxable to the extent AMT applies. Under the 2009 Act, tax-exempt interest on private activity bonds issued (or, in certain cases, reissued) in 2009 and 2010 is not considered an AMT tax-preference item.

Deduction for Taxes on Car Purchases

The 2009 Act allows an income-tax deduction for state and local sales and excise taxes paid on the purchase of qualified motor vehicles on or after the 2009 Act's enactment date and before 2010. The deduction is allowable for AMT purposes, as well. The new deduction is not allowed to taxpayers who elect to claim an itemized deduction for state and local sales taxes.

For purposes of the new deduction, a "qualified motor vehicle" is generally defined as a new passenger automobile, light truck, motorcycle, or motor home. (Certain limits apply.) The deduction is available only for taxes paid on up to $49,500 of the cost of a qualified vehicle. Further, the amount of taxes that can be deducted is phased out for taxpayers with modified adjusted gross income between $125,000 and $135,000 ($250,000 and $260,000 for married couples filing jointly).

> ***Example:*** Roberta, who is single and has 2009 modified AGI of $50,000, buys a new light truck in March 2009 for $27,000 and pays $2,200 in sales taxes. Those sales taxes are deductible in full on Roberta's 2009 federal tax return, even if she does not itemize deductions.

Child Tax Credit

Eligible taxpayers may claim a tax credit of $1,000 ($500 after 2010) for each qualifying child under age 17. For taxpayers whose regular tax and AMT liabilities are not high enough to take full advantage of the credit, the tax law allows a refund of the unused credit to the extent of 15% of the taxpayer's earned income in excess of a certain "floor" amount ($8,500 in 2008). The child tax credit is phased out for taxpayers with income over specified levels.

The 2009 Act expands the child tax credit by reducing the income "floor" so that the credit is refundable to the extent of 15% of the taxpayer's earned income in excess of $3,000 for tax years beginning in 2009 and 2010.

American Opportunity Tax Credit

Pre-2009 Act tax law provided for two tax credits that may be claimed for post-secondary education expenses: the Hope Scholarship Credit of up to $1,800 per student (for 2009) and the Lifetime Learning Credit of up to $2,000 per taxpayer. The credits phase out for taxpayers with AGI in excess of $50,000 ($100,000 for married couples filing jointly).

The 2009 Act modifies and replaces the Hope credit for tax years beginning in 2009 and 2010 and renames it the American Opportunity Tax Credit. The revised credit equals up to $2,500 per student per year for the cost of qualified tuition and related expenses (including required course materials, such as books). The credit is based on 100% of the first $2,000 of qualifying expenses and 25% of the next $2,000 of qualifying expenses.

The new credit phases out for taxpayers with AGI in excess of $80,000 ($160,000 for joint filers) and is phased out completely for those with AGI of $90,000 or more ($180,000 or more for joint filers). The American Opportunity Tax Credit is available for expenses incurred for up to four years of post-secondary education. (The Hope credit was available for only the first two years of higher education.)

> ***Example:*** The Nelsons have two children in college, David, a senior, and Ricky, a junior. They pay $10,000 of tuition and related expenses for each son in 2009. The Nelsons' 2009 joint AGI is $130,000. They may claim on their tax return an American Opportunity Tax Credit of $2,500 for each child.

The American Opportunity Tax Credit may be claimed against the alternative minimum tax, within limits. And, in the event the taxpayer does not have a large enough tax liability to apply the full credit, 40% of the credit is refundable if all tax law requirements are met.

529 Plans and Computer Costs

Section 529 qualified tuition programs are a popular way of saving for a child's or grandchild's college education. If all requirements are met, nondeductible contributions to a 529 program account and any account earnings will not be taxed upon distribution if the distribution is used for qualified higher education expenses (which generally include tuition, room and board, fees, books, supplies, and equipment required for the enrollment or attendance at an eligible educational institution).

The 2009 Act expands the definition of qualified higher education expenses to include expenses for certain computer technology, equipment, and related services (including Internet access) if such technology, equipment, and services are to be used by the 529 plan beneficiary and the beneficiary's family during any of the years the beneficiary is enrolled. Expenses for computer software designed for sports, games, etc., do not qualify unless the software is predominantly educational in nature. The law applies to expenses paid or incurred in 2009 and 2010.

Temporary Income Exclusion for Unemployment Compensation

The tax code includes federal or state unemployment compensation benefits as gross income for federal income-tax purposes. The 2009 Act provides an exclusion from gross income for the first $2,400 of unemployment benefits received by a recipient in 2009.

Transportation Fringe Benefits

Employees may exclude from income qualified transportation fringe benefits up to specified dollar limits. These benefits include van pooling, mass transit passes, qualified parking, and qualified bicycle commuting reimbursements. The 2009 Act increases the maximum monthly exclusion for combined employer-provided mass transit and van pooling benefits from $120 to $230 (for 2009; subject to future inflation adjustments). The increase is in effect for months beginning on or after the 2009 Act's enactment date and before January 1, 2011.

Business Tax Incentives

"Bonus" First-year Depreciation

In most cases, taxpayers must recover the cost of assets used in a trade or business or for the production of income through annual depreciation deductions on their tax returns. Deductions must be spread out, whether the taxpayer pays cash or finances the purchase.

The amount of the annual depreciation deduction is usually determined using a series of rules called the modified accelerated cost recovery system (MACRS). To figure the deduction for a particular item, one must know not only the property's adjusted basis, but also the recovery period, depreciation method, and placed-in-service convention applicable to that type of property under MACRS. Various IRS regulations and procedures spell out the rules.

Previous tax laws gave businesses an opportunity to significantly increase their first-year depreciation deductions by introducing, for a limited time, an additional first-year depreciation "bonus" equal to a percentage of the adjusted basis (essentially, the cost) of qualified property. The bonus percentage was set at 50% of adjusted basis. The additional depreciation deduction was allowed against both regular income tax and AMT. Several requirements had to be met for property to qualify for "bonus" depreciation. Most types of new business property qualified, other than buildings. Bonus depreciation applied to qualified property unless the taxpayer "elected out" for that property's class or classes for that taxable year.

Pre-2009 Act law provided that the bonus first-year depreciation would no longer be available for property placed in service on or after January 1, 2009. (There was an extension through the end of 2009 for longer-recovery-period property and certain transportation-related property.) But, now, the 2009 Act extends the additional first-year depreciation deduction for another year, generally for property placed in service through 2009 (through 2010 for certain longer-lived and transportation property).

Section 179 Expensing

Smaller businesses can take advantage of an election under Section 179 of the tax code to write off the cost of many types of otherwise depreciable assets in the year they are acquired and placed in service, within tax law limits. This Section 179 election generally allows taxpayers to recover their costs faster than through depreciation deductions.

Example: In 2008, Acme Corporation had taxable income of $150,000 (before any Section 179 deduction). For the year, Acme purchased and placed in service $50,000 of computers and other equipment used in the business. No other assets were purchased during the year. Acme may choose to depreciate the assets over their depreciable lives. Or Acme may elect under Section 179 to write off the entire $50,000 cost of the assets for 2008.

The tax law sets a maximum dollar limit on the cost of property eligible for the Section 179 election. That maximum is reduced dollar-for-dollar as the cost of the taxpayer's total qualifying assets placed in service during the year exceeds a certain dollar amount.

Pre-2009 Act tax law provided that, for taxable years beginning in 2008, the maximum amount a taxpayer could expense under Section 179 was $250,000. But, for taxable years beginning in 2009 and 2010, the limitation was reduced to $125,000, adjusted for inflation. (The 2009 inflation-adjusted limit was $133,000.)

Also, for taxable years beginning in 2008, the $250,000 amount was reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeded $800,000. For taxable years beginning in 2009 and 2010, this ceiling was $500,000, adjusted for inflation. (The 2009 inflation-adjusted ceiling was $530,000.)

The 2009 Act extends the enhanced Section 179 expensing limit that was in effect for 2008 to 2009. So, for qualifying property placed in service in taxable years beginning in 2009, there is a $250,000 maximum Section 179 deduction. The deduction maximum is reduced to the extent the cost of qualifying property placed in service during the taxable year exceeds $800,000. Neither limit is adjusted for inflation.

> ***Example:*** During 2009, Acme Corporation buys and places in service $700,000 of qualifying property. Acme's taxable income (before any Section 179 deduction) is $1.5 million. Acme can expense up to $250,000 of the property's cost. The remaining $450,000 of the purchases is subject to regular depreciation and may be eligible for bonus first-year depreciation.

Net Operating Loss Carryback

A net operating loss (NOL) is generally defined as the amount by which a taxpayer's business deductions exceed gross income in a particular tax year. Typically, an NOL may be carried back two years and carried forward 20 years to offset taxable income in such years.

> ***Example:*** Sam's Hardware, Inc. had taxable income of $5,000 in Year 1 and $15,000 in Year 2. In Year 3, the company suffered a $20,000 net operating loss. The company may carry back the loss to offset taxable income recognized in Year 1 and in Year 2 and potentially receive a refund of taxes paid for those years.

Different rules apply with respect to NOLs arising in certain circumstances. For instance, a five-year carryback applies to qualifying farming losses.

The alternative minimum tax rules provide that a taxpayer's NOL deduction cannot reduce the taxpayer's alternative minimum taxable income (AMTI) by more than 90% of the AMTI.

The 2009 Act allows eligible small business taxpayers to irrevocably elect to increase the carryback period from two years to as many as five years in the case of an NOL for any taxable year ending in 2008 (or, if chosen by the taxpayer, the NOL for any taxable year beginning in 2008). For example, a business incurring a net operating loss in 2008 may elect to carry the loss back to 2004 (i.e., four years), if it so chooses.

In general, for purposes of this provision, an "eligible small business" 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 NOLs for a taxable year ending before the 2009 Act's enactment, transitional rules apply. Other special rules apply as well.

Small Business Estimated Tax Payment Relief

Individuals who own small businesses and do not pay taxes through income-tax withholding are required to pay estimated taxes on their income during the course of the year. In general, the required annual payment of estimated tax is the lesser of: (1) 90% of the tax shown on the current year's tax return or (2) 100% of the tax shown on the individual's previous year's tax return (110%, if AGI for the preceding year exceeded $150,000). Failure to pay the required estimated tax could result in an estimated tax penalty.

Under the 2009 Act, in the case of any taxable year beginning in 2009, qualified individuals may pay estimated tax of 90% of the tax liability shown on the previous year's return, thus possibly lowering their estimated tax burden. A qualified individual is a person whose AGI for the preceding taxable year was less than $500,000 ($250,000 for married persons filing separately) *and* the person certifies that more than 50% of the gross income shown on the previous year's return was income from a small business. A small business for this purpose is a trade or business with fewer than 500 employees on average during the calendar year ending in or with the previous tax year.

Work Opportunity Tax Credit

The Work Opportunity Tax Credit (WOTC) is an incentive given to employers to hire disadvantaged workers in certain targeted groups. The amount of the credit available to an employer is determined by the amount of qualified first-year wages paid by the employer. The WOTC is not available for individuals who begin work for an employer after August 31, 2011.

The 2009 Act expands the WOTC to include two new targeted groups:

- *Unemployed veterans,* generally defined as those (1) discharged or released from active duty from the Armed Forces during the five-year period ending on the hiring date and (2) receiving unemployment compensation for at least four weeks during the one-year period ending on the hiring date; and
- *Disconnected youth,* meaning individuals certified as (1) having reached age 16 but not attaining age 25 on the hiring date; (2) not regularly attending any secondary, technical, or post-secondary school during the six months prior to the hiring date; (3) not regularly employed during that six-month period; and (4) not readily employable by reason of lacking a sufficient number of basic skills.

The WOTC is available to employers hiring members of these new targeted groups who begin work during 2009 or 2010.

Qualified Small Business Stock

Noncorporate taxpayers may exclude from income a portion of capital gain realized when they dispose of "qualified small business stock" (QSBS) held more than five years and meeting other requirements. Under pre-2009 Act law, the exclusion generally equaled 50% of up to $10 million (or ten times the taxpayer's tax basis, if greater) of the gain on the disposition of QSBS. The remainder of the gain is taxable at the lesser of the taxpayer's ordinary income-tax rate or 28%. The 2009 Act increases the exclusion to 75% for qualifying stock acquired after the date of the new law's enactment and before 2011.

> ***Example:*** Hi-Tech, Inc. issues qualified small business stock in 2010 to its new minority owner, Jim, in exchange for $200,000. After holding the stock for six years and meeting all other tax law requirements, Jim sells the stock for $600,000. Jim can exclude $300,000 (75% of the $400,000 gain) from his income for tax purposes. The remaining $100,000 of gain is taxable.

S Corporation Built-in Gains

Where a corporation is formed as a regular C corporation and later elects to become an S corporation (one that, essentially, passes through its income, deductions, losses, and tax credits to its shareholders to be reported directly on the shareholders' tax returns), the S corporation is taxed on all "built-in" gains on the corporation's assets if the gains are recognized (for instance, if the assets are sold at gains) within a defined period after the S corporation election is made. The 2009 Act temporarily reduces that "recognition period" from ten years to seven years for tax years that begin in 2009 and 2010.

Withholding on Certain Government Payments for Goods/Services

The 2009 Act would delay for one year the 3% withholding requirement on certain payments to persons who supply goods or services to eligible federal, state, and local governments, which was scheduled to go into effect for payments after December 31, 2010. Now, withholding is required for payments after December 31, 2011.

COBRA-related Provisions

COBRA Insurance Continuation

Under a law known as "COBRA," an employee (or an employee's family member) whose group health coverage has been terminated has the option of continuing the coverage by paying the employer the full amount of the premium (plus a small administrative fee). The employee (or other eligible individual) generally has the right to continue this coverage for at least 18 months. (Some exceptions apply.)

The 2009 Act provides that an individual who has been involuntarily terminated (and any qualified beneficiary of that individual) is required to pay only 35% of the premium to continue COBRA coverage under a group health plan for up to nine months.

The employer (or other entity to which the COBRA premium is payable) must pay the remaining 65%.

However, the employer is reimbursed for the amount of the COBRA premium assistance it pays on the individual's behalf by claiming a credit against any federal income-tax or FICA withholding taxes it owes on wages paid. If the reimbursable amount is more than the payroll tax liability, the IRS will reimburse the employer directly. The COBRA premium subsidy generally is not taxable to the participant.

Participants whose modified AGI for the same year in which they receive COBRA premium assistance exceeds $145,000 ($290,000 for joint filers) will have to repay the premium subsidy to the government through a recapture tax. For those with modified AGI between $125,000 and $145,000 (between $250,000 and $290,000 for joint filers), the amount of the subsidy for the taxable year that must be recaptured is reduced proportionately. A high-income individual eligible for COBRA continuation coverage may make a permanent election to waive the right to the premium subsidy for all periods of coverage to avoid being subject to the recapture tax.

The new provision applies to qualifying individuals who become eligible for COBRA continuation coverage anytime from September 1, 2008, through December 31, 2009. Workers who were involuntarily terminated between September 1, 2008, and the date of the 2009 Act's enactment, and who failed to elect COBRA continuation at the time due to its unaffordability, will have an additional 60 days after notice is provided to elect COBRA and receive the subsidy. Additional COBRA notice and reporting requirements are included in the new law.

Energy Tax Incentives

The new law provides several energy-related tax provisions intended to provide incentives for producing and conserving energy from renewable sources. Examples of these provisions include:

Non-business Energy Credits. — Current tax law (Section 25C) allows tax credits for making certain energy-efficient improvements (new insulation or

exterior windows and doors, for example) to existing residential property and for purchasing specified energy-efficient property (e.g., heat pumps). The 2009 Act extends these tax credits through 2010. For 2009 and 2010, the credit percentage for qualified energy-efficient improvements made during the tax year increases from 10% to 30%, and energy-efficient property purchases also are eligible for a 30% credit. There is an aggregate cap on the credits of $1,500 for property placed in service in 2009 and 2010. Other changes apply.

Removal of Dollar Limits on Certain Energy Credits. — Under pre-2009 Act law, businesses may claim a 30% business energy tax credit for certain small wind energy property, with a cap of $4,000 a year. Individuals may claim a 30% credit for qualified solar water heating property ($2,000 cap), qualified small wind energy property ($4,000 cap), and qualified geothermal heat pumps ($2,000 cap). The 2009 Act repeals all of the above caps, effective for tax years beginning after 2008.

Renewable Electricity Production Credit. — The tax law allows an income-tax credit for the production of electricity from qualified energy resources at qualified facilities. The 2009 Act extends the period during which qualified facilities producing electricity from wind, closed-loop biomass, open-loop biomass, geothermal energy, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy may be placed in service and qualify for the credit through 2013 (2012 for wind facilities).

Qualified Advanced Energy Manufacturing Project Credit. — The new law provides a 30% credit for investment in qualified property (buildings are excluded) used in a qualified advanced energy manufacturing project associated with fuel cells, battery technology, renewable energy production technologies, efficient transmission and distribution of electricity, and carbon dioxide capture and sequestration. Additional requirements apply.

Plug-in Electric Vehicle Credit. — The existing plug-in electric drive motor vehicle credit is modified by excluding low-speed vehicles. A new 10% nonrefundable credit (up to $2,500) is allowable for low-speed vehicles, motorcycles, and three-wheeled vehicles that otherwise meet the law's requirements. The new credit is in effect for vehicles bought after the enactment date of the new law through December 31, 2011.

Can We Help?

The American Recovery and Reinvestment Tax Act of 2009 is only one part of an overall economic stimulus law that also contains spending provisions intended to aid in the recovery of the manufacturing sector, make funding available to state and local governments for infrastructure and other projects, and provide assistance to families and unemployed workers.

The provisions of the new law described here are intended to stimulate the economy through individual and business tax breaks. It is important to consider your tax and financial situation now and determine how the 2009 Act will affect you. We can help with your planning. Let our professionals be of service to you.

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. However, the general information herein is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purposes of avoiding tax penalties.

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REYNOLDS
BONE &
GRIESBECK PLC
CERTIFIED PUBLIC ACCOUNTANTS & ADVISORS

Clark Centre
5100 Wheelis Drive, Suite 300
Memphis, Tennessee 38117-4558
901-682-2431 Fax 901-683-5482
www.rbgcpa.com

RRA