Tax Tips

American Recovery and Reinvestment Tax Act of 2009

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The President and Congress have responded to the current economic crisis by drafting legislation that provides, among other changes to the law, significant changes to the Internal Revenue Code. The portion of the legislation making changes to the Code is titled the "American Recovery and Reinvestment Tax Act of 2009" (the "Act"). The Act's changes to the Code affect a broad range of taxpayers, from businesses to individuals. The following summary is focused on the more relevant provisions for your business clients.[1]

1) *Extension for Bonus Depreciation.* Section 168(k) provides for "bonus depreciation" equal to an immediate 50% depreciation deduction on certain property purchases in addition to the normal depreciation permitted for such asset. Under current law, the qualifying property must be placed in service by the taxpayer prior to January 1, 2009, except for certain "longer production" property (such as transportation property) which may be placed in service by January 1, 2010. The Act extends the general deadline for placing the property in service to January 1, 2010, with the deadline for placing longer production property in service being extended to January 1, 2011.

2) *Small Business Expensing.* Section 179 permits certain taxpayer to elect to deduct the cost of section 179 property in the year such property is placed in service instead of capitalizing such cost. The deduction is limited, with a phase-out for costs in excess of the limitation. For example, the limits for 2009 before the passage of the Act were to be $133,000 for the maximum expense deduction, with the amount of the taxpayer's deduction being reduced dollar for dollar by the amount that the cost of the Section 179 property exceeds $530,000 (the limits are adjusted for inflation). The Act raises the limitation on the expense deduction to $250,000 for 2009, with the phase-out beginning at $800,000.

3) *Expanded NOL Carryback. A* significant benefit to qualifying businesses provided by the Act is a modification of Section 172(b)(1) relating to carry back of net operating losses. Under pre-Act law a taxpayer may only carry back net operating losses for 2 years prior to the current tax year. This Section is amended by the Act to permit NOLs incurred in the tax year beginning or ending in 2008 by "eligible small businesses" to be carried back for up to 5 years. An "eligible small

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[1]For further analysis of the Act, I recommend RIA's Complete Analysis of the Tax and Benefits Provisions of the American Recovery and Reinvestment Act of 2009 published by Thomson Reuters/RIA.

business" is any trade or business with $15 million or less in average annual gross receipts for the three year tax period ending with the tax year in which the NOL arose. The gross receipts of related entities are included in the determination of whether a taxpayer is an eligible small business.

4) *New Employee Tax Credit.* The work opportunity tax credit under §51 is expanded to include two new groups of eligible employees hired in 2009 or 2010: unemployed veterans and disconnected youth. An unemployed veteran is an individual who has been discharged or released from armed forces duty for the five year period ending on the hiring date and has been receiving unemployment compensation for not less than 4 weeks during the one year period ending on the hiring date. Disconnected youth is an individual between the ages of 16 to 25 who has not been attending school or regularly employed for the past six months and who is certified by the designated agency as not being readily employable by reason of lacking a sufficient number of basic skills. The maximum credit per employee is $2400.

5) *COD Relief for Debt Reacquisition.* Section 108 is amended in regard to the reacquisition of a debtor's debt instrument from the creditor. Under current law if in the course of a workout a debtor purchases his debt instrument from the creditor, then such debtor is generally treated as recognizing cancellation of indebtedness income equal to the difference between the balance of the debt and the amount paid for the debt instrument. The taxable income is includible in the year of discharge. The Act modifies this rule by deferring and spreading out the income inclusion over time. If the debt is reacquired in 2009 then the debtor shall include the income ratably over 8 years with the first income inclusion year beginning in 2011. If the reacquisition occurs in 2010 then the taxpayer incurs taxable income ratably over 8 years with the first income inclusion year beginning in 2011. This deferral is only applicable to purchases by the debtor, not third parties purchasers. "Reacquisition" is broadly defined to include the purchase of a debt instrument, the retirement of a debt instrument, conversion of a debt instrument into equity, or exchange of the original debt instrument for a new debt instrument. This amendment is significant in that it may provide an alternative for taxpayers who are attempting to workout their debts without having to include income for up to 2 years after the discharge.

6) *Increase in Gain Exclusion for Qualified Small Business Stock Sale.* Under pre-Act law a noncorporate taxpayer may exclude 50% of gain recognized from the sale of qualified small business stock held for more than five years by the taxpayer after the original issue, with the maximum amount of excludable gain being the greater of ten times the basis in the stock or $10 million. The Act amends this rule to increase the gain excluded from the sale of qualified small business stock from 50% to 75% if the stock is acquired at any time after the date of enactment of the Act but before January 1, 2011. The Act retains the definition of qualified small business as being a subchapter C corporations with less than $50 million in assets.

7) *Modification of 10-year Recognition Period for S Corporations.* There is some relief for S corporations with built-in gains. Under current law Section 1374(d) requires an S corporation

to be taxed at the corporate rate on built-in gains recognized during a 10 year period after the conversion from subchapter C status to the extent of net unrealized built in gain for assets held on the day of the conversion. The Act modifies this rule for 2009 and 2010 to reduce the 10 year recognition period to 7 years if the 7th taxable year occurs prior to 2009 or 2010. In other words if your client has been a S corporation for 7 or more years after its conversion from a C corporation then the disposition of any assets with built-in gain will not trigger a corporate level tax during 2009 or 2010.

8) *AMT Patch.* The alternative minimum tax ("AMT") applies to an individual's alternative minimum taxable income, reduced by such individual's exemption amount. The Act raises this exemption amount from $46,200 in 2008 to $46,700 in 2009 for singles and heads of household and from $69,950 in 2008 to $70,950 in 2009 for joint filers and surviving spouses.

As you can see from this summary there may be potential planning opportunities for your clients, some of which have a small window of opportunity due to time limits. If you would like to discuss how these tax provisions may apply to a particular client, please feel free to contact Davis Smith at (334)409-2219.