

Re: 2009 Recovery Act: General Information

Dear Client:

Acting quickly to jump start the economy, Congress has passed a massive economic stimulus package: the American Recovery and Reinvestment Act of 2009 (2009 Recovery Act). As you probably have heard, the new law weighs in at nearly \$800 billion. Roughly one-third is comprised of tax incentives for individuals and businesses. Congress made many of the tax incentives retroactive to January 1, 2009.

The tax incentives in the stimulus package can be broken down into two broad categories: individuals and business. Let's take a look at the individual incentives first.

Individual Incentives

Making Work Pay credit. Starting later this year, eligible wage earners will see an increase in their take-home pay. The 2009 Recovery Act provides a credit against income tax in an amount equal to the lesser of 6.2 percent of the individual's earned income or \$400 (\$800 for married couples filing jointly). However, income limitations apply so the credit is unavailable to higher income wage earners.

Effective April 1, 2009, employers have started withholding at reduced rates to reflect the Making Work Pay credit. Many individuals will benefit from an automatic and immediate increase in their take home pay. However, married couples whose combined incomes place them in a higher tax bracket and individuals with more than one job may want to submit a revised Form W-4 to their employers to ensure that enough withholding is held. Our office can help you determine if you should submit a revised Form W-4 to your employer.

Seniors and others. Individuals receiving Social Security benefits, disabled veterans and others on fixed incomes will receive one-time payments of \$250. If the individual also qualifies for the Making Work pay credit, his or her credit will be reduced by the \$250 payment. The Social Security Administration, which will be sending the bulk of the one-time payments, has announced it will start making the payments by mail and direct deposit in May 2009.

First-time homebuyer tax credit. In 2008, Congress enacted the first-time homebuyer tax credit. Unlike other credits, this one had to be repaid, making it unattractive to many taxpayers. The 2009 Recovery Act removes the repayment requirement for homes purchased by first-time buyers between January 1, 2009 and December 1, 2009. The enhanced credit equals 10 percent of the purchase price of a home up to \$8,000 (\$4,000 for married individuals filing separately). There are income limitations, which preclude higher-income individuals and couples from taking advantage of the credit. In a taxpayer-friendly move, the IRS has announced that individuals who purchase a home in 2009 may claim the \$8,000 credit on their 2008 returns. However, individuals cannot claim the credit before they finalize the purchase of their home.

New car deduction. Automobile sales, like new home sales, have plummeted in recent months. In response, Congress has created a non-itemized deduction for state and local sales taxes or excise taxes paid on qualified purchases of new motor vehicles. The vehicle must be purchased after February 16, 2009, and before January 1, 2010, to qualify for the deduction. Income thresholds and other limitations apply.

AMT patch. Every year, bills are introduced in Congress to abolish the alternative minimum tax (AMT). This year is no different but because the federal budget deficit, Congress cannot eliminate the AMT without finding an equivalent source of revenue. However, there is some good news. The 2009 Recovery

Act increases the AMT exemption amounts and allows taxpayers to take most personal credits to reduce AMT liability for 2009.

Child tax credit. The current \$1,000 child tax credit is one of the most popular incentives in the Tax Code. The 2009 Recovery Act increases the refundable portion of the child tax credit for 2009 and 2010. Taxpayers are eligible for a refundable credit equal to 15 percent of their earned income in excess of \$3,000 subject to certain restrictions and phase-outs.

Unemployment compensation. Many individuals are surprised to learn that unemployment benefits are taxable. The 2009 Recovery Act excludes up to \$2,400 in unemployment compensation from a recipient's gross income in 2009.

Education. The Tax Code includes a number of incentives to help bring down the cost of education. The 2009 Recovery Act expands the current Hope education credit (and renames it the American Opportunity Tax Credit). More individuals will be able to take advantage of this credit because of expanded income phase-outs. The 2009 Recovery Act also raises the maximum credit, extends it over four years of post-secondary school education, and makes 40 percent of the credit refundable. In a related development, the 2009 Recovery Act also permits beneficiaries of qualified tuition plans (known as "529" plan) to use tax-free distributions to pay for computers and computer technology.

Transit benefits. Individuals who take public transportation to work or van pool may benefit from enhanced transit incentives in the new law. Congress increased the income exclusion amount for transit passes and van pooling from \$120 per month to \$230 per month for 2009 (starting in March 2009) and through 2010 with an inflation adjustment. However, these benefits must be offered by your employer to take advantage of them.

EITC. The earned income tax credit (EITC) is a refundable tax credit targeted to lower and middle income wage earners and families. When the EITC exceeds the amount of taxes owed, it generates a refund. The 2009 Recovery Act enhances the EITC for taxpayers with three or more qualifying children and helps eliminate an existing "marriage penalty" across the board.

Energy Incentives. The 2009 Recovery Act enhances several energy tax incentives that reward taxpayers for installing energy-efficient property and alternative sources of energy in their homes. Among the types of energy-efficient property that may qualify for a tax break are certain heat pumps, furnaces, windows and doors. There's also a tax break for purchasers of plug-in electric vehicles.

Business Incentives

Although the business incentives in the new law are not as expansive as in some recent tax acts, they are still valuable.

Bonus depreciation. Bonus depreciation is one of Congress' favorite mechanisms (along with Code Sec. 179 expensing) to encourage business spending. The 2009 Recovery Act extends 50 percent bonus depreciation that expired at the end of 2008. Businesses can take advantage of bonus depreciation throughout 2009 (and longer for certain types of property). Bonus depreciation is taken on top of regular depreciation. While it can be valuable in the short term, keep in mind that a large current depreciation deduction results in smaller future deductions. Also good news in applying bonus depreciation to vehicles, the 2009 Recovery Act raises the first-year depreciation cap limits by \$8,000. The 2009 Recovery Act also allows eligible businesses to monetize accumulated AMT and research tax credits in lieu of taking bonus depreciation for 2009.

Code Sec. 179 expensing. Like bonus depreciation, increased Code Sec. 179 expensing expired at the end of 2008. The 2009 Recovery Act revives it for 2009. Under the new law, Code Sec. 179 expensing for 2009 is \$250,000 and the threshold for reducing the deduction is \$800,000.

Net operating losses. Because of the economic downturn, many businesses are in a loss position. The Tax Code generally allows eligible taxpayers to carry back net operating losses (NOLs) two years with some exceptions. The 2009 Recovery Act increases the carryback period to five years for small businesses (which the new law defines as businesses with average gross receipts of \$15 million or less). The treatment is also temporary, applying only to 2008 NOLs. Businesses that qualifying can apply for an immediate refund of taxes paid during the extended carryback period. Taxpayers that previously elected to forego the two-year carryback can revoke that election and make a new election to claim the extended carryback under the new law. However, the revocation had to have been made by April 17, 2009.

Work Opportunity Tax Credit. The Work Opportunity Tax Credit rewards employers that hire individuals from targeted groups, such as veterans and young people. The 2009 Recovery Act modifies the definitions of eligible veterans and disconnected youth for purposes of the credit.

Cancellation of indebtedness. Eligible businesses will be able to recognize cancellation of certain indebtedness over five years, beginning in 2014, under the 2009 Recovery Act. This treatment applies to specified types of business debt repurchased or forgiven by the business after December 31, 2008 and before January 1, 2011.

Energy incentives. The 2009 Recovery Act extends and enhances many energy tax incentives for developers and producers of alternative and renewable energy. Examples are wind, biomass and solar power. The incentives are temporary and are intended to boost production of energy from renewable sources.

COBRA coverage. Individuals who are involuntarily separated from employment between September 1, 2008 and January 1, 2010 can elect to pay 35 percent of their premiums for COBRA coverage and will be treated under the 2009 Recovery Act as paying the full amount. The former employer will pay the remaining 65 percent of the premium. In return, the employer will be able to credit its share of this temporary COBRA subsidy against wage withholdings and payroll taxes. The COBRA subsidy is generally only available for nine months. The Department of Labor has issued model notices that employers can send to former employees who are eligible for the COBRA subsidy. The IRS has also issued guidance on what qualifies as involuntary termination for purposes of the COBRA subsidy.

More business incentives. The 2009 Recovery Act also allows qualified individuals to exclude 75 percent of the gain from the sale of certain small business stock. Additionally, Congress shortened the holding period for the S corp built-in gain period, prospectively revoked a controversial IRS notice affecting NOL limitations on banks and enhanced the health coverage tax credit. The 2009 Recovery Act also increases the New Markets Tax Credit program, decreases estimated tax payments for certain individuals whose incomes come from small businesses and delays withholding on government contractors. Congress also enhanced many tax-exempt and tax-credit bond rules to help states and local governments generate revenue.

The scope of the American Recovery and Reinvestment Act is broad. Please contact our office to discuss how the tax incentives in the new law may benefit you.

Sincerely yours,