



Washington Tax Report

The American Recovery and Reinvestment Tax Act of 2009

Last week Congress passed and yesterday the President signed the American Recovery and Reinvestment Tax Act of 2009 (the "Act"). The Act contains approximately \$300 billion of net tax cuts, including the following:

Business Tax Provisions

Bonus Depreciation

The Act extends the 50 percent bonus depreciation through 2009, retroactive to January 1, 2009. The Act also extends the bonus depreciation through 2010 for property with a recovery period of ten years or more, for transportation equipment and certain aircraft.

Higher Limit on Vehicle Depreciation

The Act extends the increase in the dollar cap on vehicle depreciation by \$8,000 for new vehicles placed in service in 2009 if bonus depreciation is claimed on the property. The purpose of the temporary increase is to prevent the benefits of bonus depreciation from being eliminated by the special limits on motor vehicle depreciation. The first-year dollar limitation is adjusted annually for inflation, but we expect that the increased amount for 2009 will be approximately \$10,960, the same as in 2008.

First Year Expensing

The Act extends the section 179 expensing limit of \$250,000 and the threshold for reducing the deduction of \$800,000 for property placed in service in 2009. These increased limits previously applied only to property placed in service in 2008.

Net Operating Loss Carryback

The Act allows taxpayers to carry back net operating losses arising in 2008 for three, four, or five taxable years, rather than the current two taxable years. The provision applies only to an eligible small business, which is defined as a business with average annual gross receipts of less than \$15,000,000 (taking into account the gross receipts of certain related taxpayers). The Conference Agreement dropped the provision of the House bill that provided that the amount of the net operating loss would be reduced by ten percent if the additional carryback period is used.

Refundable Credits

The Act extends through the end of 2009 a provision that permitted corporations to monetize some of their older unused alternative minimum tax and research and development tax credits. Under this provision, a corporation that is eligible for bonus depreciation may elect instead to claim additional refundable alternative minimum tax or research and development tax credits. The credits are increased by 20 percent of the difference between depreciation claimed on eligible property with and without bonus depreciation. The amount is limited to the lesser of six percent of the accumulated credits or \$30 million.

Work Opportunity Credit

The Act adds unemployed veterans and disconnected youth to the list of targeted groups eligible for the credit. This provision applies to individuals who are hired and begin work in 2009 or 2010.

Cancellation of Debt Income

Under the Act, a taxpayer that reacquires its business debt would recognize any cancellation of debt income ratably over five years beginning in 2014 for debt reacquired after December 31, 2008, and before January 1, 2011. The provision broadly applies to debt acquired directly by the debtor or through a related person, and to most types of acquisitions, including through cash settlement,

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modification, issuance of a new debt instrument, forgiveness, or issuance of equity instruments.

Scope of Section 382

The Internal Revenue Service issued Notice 2008-83 relieving banks and other financial institutions from the application of certain aspects of section 382 regarding the use of built-in losses following an ownership change. The Act generally terminates the application of this Notice for transactions after January 16, 2009 (subject to certain transitional rules), using strongly-worded language indicating that the Treasury Department and the Service had exceeded their authority in issuing the Notice.

S Corporation Built-in Gains Tax Relief

Under the Act, the recognition period for the section 1374 built-in gains tax imposed on S corporations would be temporarily reduced from ten years to seven years for taxable years beginning in 2009 or 2010. This provision generally provides a benefit for C corporations that converted to S corporation status in taxable years beginning in 2000 through 2003.

Individual Tax Provisions

Making Work Pay Tax Credit

The Act provides for an income tax credit equal to the lesser of 6.2 percent of an individual's earned income or \$400 (\$800 for married couples filing a joint return). The credit would be reduced, but not below zero, if an individual's modified adjusted gross income exceeds \$75,000 (\$150,000 in the case of married couples filing jointly). The credit applies to 2009 and 2010.

Economic Recovery Payment

The Act provides for a one time payment of \$250 for 2009 to Social Security beneficiaries and SSI recipients, to veterans receiving disability compensation and pension benefits from the Department of Veterans Affairs and to retired government employees. Recipients of this payment will be subject to a dollar-for-dollar reduction in the amount of the otherwise available Making Work Pay Tax Credit.

Alternative Minimum Tax

The Act contains a patch for 2009 to the AMT. The patch increases the exemption amounts to \$70,950 for married couples filing a joint return and surviving spouses (increased from \$69,950 in 2008) and \$46,700 for singles and heads of households (increased from \$46,200 in 2008) and allows taxpayers to claim most personal tax credits to reduce AMT liability.

Education Credit

The Act increases for 2009 and 2010 the HOPE credit from the current maximum of \$1,800 to \$2,500 per year, includes textbooks as a qualifying expense, extends the period of eligibility for the credit from two years to four years, and increases the income phase-out levels from \$50,000 (\$100,000 for married couples filing a joint return) to \$80,000 (\$160,000 for married couples filing a joint return). The maximum credit is obtained by incurring \$4,000 of qualifying expenses, consisting of 100 percent of the first \$2,000 of expenses and 25 percent of the next \$2,000 of expenses. The credit would be renamed the American Opportunity Tax Credit and would be available for credit against the AMT liability. In addition, 40 percent of the credit would be refundable.

Unemployment Compensation

The Act excludes the first \$2,400 of unemployment compensation from taxable income in 2009.

First Time Homebuyer Credit

In 2008, Congress enacted a tax credit for first time homebuyers for homes purchased on or after April 9, 2008, and before July 1, 2009. However, the credit must be repaid ratably over 15 years. The Act increases the maximum credit from \$7,500 to \$8,000, extends it through November 30, 2009, and eliminates the required repayment obligation after 36 months in the home. These enhanced provisions apply to homes purchased after December 31, 2008, and through November 30, 2009. The credit phases out for taxpayers with adjusted gross income above \$75,000 (\$150,000 for married couples filing a joint return).

New Vehicle Deduction

The Act allows taxpayers to claim an above the line deduction for the sales and use taxes or excise taxes paid on the purchase of a new car, motorcycle, light truck, or recreational vehicle. Because the deduction is above the line, taxpayers who do not itemize their deductions can benefit from it. The deduction is limited to taxes paid on the first \$49,500 of the purchase price and is phased out for taxpayers with adjusted gross income exceeding \$125,000 (\$250,000 for married couples filing a joint return).

Child Tax Credit

Under current law, the child tax credit of \$1,000 per child is refundable to the extent of 15 percent of earned income in excess of \$8,500. For 2009 and 2010 the Act increases the refundable portion of the child tax credit by reducing the income threshold to \$3,000.

Earned Income Tax Credit

The Act increases the credit from 40 percent to 45 percent of the first \$12,570 of earned income for taxpayers with three or more children.

Transit Benefits

The Act increases the exclusion for transit passes and van pooling employers can provide to employees from \$120 per month to \$230 per month starting in March 2009 and extends the increased amount through 2010 with an inflation adjustment.

Small Business Capital Gains

The Act increases the gain exclusion on small business stock from 50 percent to 75 percent for stock acquired after February 17, 2009, and before January 1, 2011, and held for more than five years.

COBRA Benefits

The Act enacts a subsidy for unemployed workers to pay for their health insurance premiums. Under the Act, the employee pays 35 percent of the cost of the COBRA coverage. The former employer is required to pay the remaining 65 percent of the cost. The former employer is entitled to a credit against its income tax withholding and payroll taxes for this amount. The benefit is phased out for

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taxpayers with adjusted gross income exceeding \$125,000 (\$250,000 for married couples filing a joint return). The provision applies to employees who are involuntarily separated from employment between September 1, 2008, and January 1, 2010, but is only effective for months of coverage beginning after February 17, 2009.

Energy Provisions

Energy Investment Credit

Under current law, the energy investment credit is limited to \$4,000 per year. The Act repeals the cap for qualified small wind energy property placed in service after 2008.

Renewable Electricity Production Credit

Current law allows a production credit for electricity produced from renewable sources. The Act extends the placed in service date for qualified wind facilities through December 31, 2012. The placed in service date for most other property is extended through December 31, 2013.

Investment Credit Election

In lieu of claiming the production credit, the Act allows taxpayers to treat certain qualified property as eligible for the 30 percent investment credit.

Residential Energy Credit

The Act increases the credit from 10 percent to 30 percent, raises the maximum credit to \$1,500 for 2009 and 2010, and eliminates the \$500 lifetime cap.

Alternative Refueling Stations

The Act increases the business credit for alternative vehicle refueling property from 30 percent to 50 percent, and increases the maximum credit from \$30,000 to \$50,000. The credit for non business property is increased to \$2,000.

Other Provisions

Withholding on Government contractors

The Act defers the effective date, from December 31, 2010 to December 31, 2011, of the requirement that government agencies withhold three percent of payments to contractors.

Private Activity Bonds

The Act excludes interest on private activity bonds issued during 2009 or 2010 from the alternative minimum tax.

Tax Credit Bonds

In lieu of interest, holders of tax credit bonds receive a federal tax credit. The Act allows state and local governments to temporarily elect to issue tax credit bonds rather than tax-exempt governmental obligation bonds.

Recovery Zone Bonds

The Act creates two categories of tax credit bonds for 2009 and 2010. The Act provides \$10 billion in recovery zone economic development bonds and \$15 billion in recovery zone facility bonds. These limits would be allocated among the states.

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