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Economic Stimulus Act of 2009 and General Update

Background

Began with recovery rebate credit reflected on 2007 and 2008 individual tax returns.

On February 17, 2009, the President signed, the “American Recovery and Reinvestment Tax Act of 2009”, a comprehensive economic stimulus package with a total price tag approaching \$800 billion, and including a number of important tax provisions and incentives.

Business Tax Provisions

50% Bonus Depreciation

50% bonus depreciation is extended through 2009, effective for property acquired and placed in service in 2009.

Applies to new property with a recovery period of 20 years or less and to qualified leasehold improvements (see below).

New vehicles are allowed an extra \$8,000 deduction in addition to the normal first year limit of about \$3,000.

Mandatory, unless you elect to not take it. Can elect to use or not use within any asset class, but cannot pick and choose assets within a class.

- The term “class of property” refers to the 3, 5, 7, 10, 15, and 20 year recovery period classes. The election to not claim the 50% must be made for all additions within an entire class placed in service for the tax year.
- An election to not claim the bonus depreciation must be made by the due date (including extensions) of the federal return for the year in which the qualified property is placed in service by the taxpayer.
- The election, once made, is irrevocable.

The Learning Curve

Keeping you on the road to financial health

Qualified leasehold improvement property: must meet all of the following tests to qualify for the 50% bonus depreciation:

- Interior portion of a building.
- Non residential real property.
- Pursuant to a lease by either the lessee, sublessee, or by the lessor to property to be occupied exclusively by the lessee or sublessee.
- Placed in service more than three years after the date the building was first placed in service.
- Ineligible if expenditures are for the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building.
- Leases between related persons are not qualifying. Members of an affiliated group are considered related, as well as related parties as defined in IRC Sec. 267(b) (but using an “80% or more” definition rather than “more than 50%.”).

Regular depreciation is allowed on the remaining 50% of those assets for which bonus depreciation is taken.

Not limited to any amount, and not limited to taxable income.

Note: Minnesota and many other states do not allow the 50% bonus depreciation.

Section 179 Expense

As with the 50% bonus, this is a one year continuation of a provision enacted in 2008, in which the maximum expensing and asset addition limits were greatly increased.

The increased Section 179 expensing amounts are extended to taxable years beginning in 2009.

Can expense up to \$250,000 of qualifying property. Maximum availability phases out dollar-for-dollar if qualifying asset additions exceed \$800,000.

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Keeping you on the road to financial health

Can be new or used

Limited to taxable income – cannot create or increase a net operating loss.

For both 50% bonus and Section 179, AMT is the same as regular tax.

Note: Minnesota and many other states limit Section 179 expensing.

Net Operating Loss Carryback

Eligible small business taxpayers are allowed to elect to carryback a net operating loss (NOL) 3, 4 or 5 years (taxpayers are normally allowed only a two-year carryback period).

NOLs eligible for the extended carryback period include NOLs only for taxable years beginning or ending in 2008.

- Fiscal year entities can elect to apply the new carryback provision either to its fiscal year beginning or ending in 2008, but not both.
- The common parent of a group of corporations filing a consolidated return makes the election, which is then binding on all members.

Eligible small business taxpayer is defined as a corporation, partnership, or proprietorship with average three year gross receipts (calculated as average gross receipts for the three year period ending with the NOL year) of \$15 million or less.

Eligible taxpayers who opt for a 3, 4 or 5 year NOL carryback under this rule must file an election by the due date (including extensions) for the tax return for the year of loss. The election is irrevocable. The IRS will provide guidance on making this election.

Expansion of Work Opportunity Tax Credit (WOTC)

Provides a credit of up to \$2,400 (40% of the first \$6,000 of wages) for the hire of various categories of disadvantaged workers.

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Expanded WOTC applies to individuals beginning work for an employer during 2009 and 2010.

Expanded to include two new targeted groups:

- Unemployed veterans, defined as individuals who served on active duty (other than for training) in the Armed Forces for more than 180 days or who have been discharged for a service-connected disability, have been discharged or released from active duty in the Armed forces during the five-year period ending on the hire date, and who received unemployment compensation for not less than four weeks during the one-year period ending on the hiring date.
- Disconnected youths, defined as individuals between the ages of 16 and 25 who have not been regularly employed or attending school within the past six month period, and who are not readily employable by reason of lacking a sufficient number of basic skills as certified by the local designated agency.

COBRA Continuation Coverage

A 65% health insurance premium subsidy is provided for nine months to employees involuntarily terminated from September 10, 2008 through December 31, 2009.

- As long as the employee pays 35% of the insurance premium, the group health plan is required to treat the individual as having paid the full premium required for COBRA continuation coverage.
- The plan is reimbursed for the 65% difference between the full premium and the amount paid by the employee.

The IRS has revised Form 941, *Employer's Quarterly Tax Return*, allowing employers to reduce their quarterly employment tax liability to obtain the benefit of the reimbursement for the premium difference, or the employer can file separately for a refund of that amount.

Deferral and Ratable Inclusion of Debt Discharge Income

Business taxpayers are allowed to defer debt discharge income from reacquisition or payoff of their debt instruments at a discount in 2009 and 2010.

The Learning Curve

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- If realized in 2009 – deferred and included ratably in income in each of 5 taxable years beginning with the fifth taxable year following the taxable year in which the discharge occurs.
- If realized in 2010– deferred and included ratably in income in each of the 5 taxable years beginning with the fourth taxable year following the taxable year in which the discharge occurs.

Applies to debt instruments, notes and contracts issued by a C corporation or any other person in connection with the conduct of a trade or business.

Election is required, made on a debt by debt basis, and precludes use of the other debt relief provisions applicable to bankruptcy, insolvency, qualified farm debt or qualified real estate debt.

Note: Taxpayers with an NOL that might otherwise expire unused that could be used to offset the debt discharge income could benefit by not making the election to defer the debt discharge income.

Section 1202 Stock

Exclusion of gain from the sale of Section 1202 small business C corporation stock held more than 5 years is increased from 50% to 75% for stock acquired after February 17, 2009 and before 2011.

- Effectively drops the regular tax rate on this stock to 7% (75% exclusion times Sec. 1202 rate of 28%).

S Corporation Built-in Gains Tax

For taxable years beginning in 2009 and 2010, the built-in gains tax does not apply if the entity has been in S corp. status for at least 7 years.

- Accordingly, for built-in gains existing at the time a C corporation is converted to an S corporation, no built-in gains tax attributable to the sale or distribution of assets is imposed after the seventh taxable year the S

The Learning Curve

Keeping you on the road to financial health

corporation election is in effect.

Individual Tax Provisions

Making Work Pay Credit

New refundable tax credit (“Making Work Pay” credit) applies for 2009 and 2010, equal to 6.2% of the earned income of a taxpayer, limited to \$400 for individuals and \$800 on a joint return.

- Credit is reduced by 2% of the taxpayer’s modified AGI exceeding \$75,000 on a single return and \$150,000 on a joint return,
- Means single filers over \$95,000 and joint filers over \$190,000 of modified AGI receive no credit. The credit is reduced by the amount of any “Economic Recovery Payment” received by a retiree (see below).
- Not available if taxpayer is a dependent.
- Earned income includes wages, salaries, tips, taxable self-employment income, and tax-exempt combat pay.
- Treasury Department has revised the tax withholding schedules for 2009 so that the withholding amounts of taxpayers for the remainder of 2009 reflect the full-year annual benefit of this provision, and should have issued a publication to employers in Mid-March.

First-time Homebuyer Credit

The existing refundable first-time homebuyer credit is extended and modified for qualifying home purchases prior to December 1, 2009.

- Maximum credit amount is increased to \$8,000 (was \$7,500 in 2008) and the 15 year automatic recapture of the credit is waived for qualifying home purchases between January 1, 2009 and November 30, 2009.
- Taxpayers may elect to treat any 2009 home purchase as occurring on December 31, 2008 and file a 2008 Form 1040X to claim the credit.
- Credit phases out as single AGI increases from \$75,000 to \$95,000 or joint AGI increases from \$150,000 to \$170,000.

The Learning Curve

Keeping you on the road to financial health

- The 15-year recapture provision still applies for homes purchased before January 1, 2009, but a 2009 credit electively claimed in 2008 is not subject to this recapture.
- Recapture applies if the taxpayer disposes of the home or the home otherwise ceases to be the principal residence of the taxpayer within 36 months from the date of purchase. The recapture is limited to the gain on the sale.

Expanded Earned Income Credit (EIC)

The EIC is increased for families with three or more children to a maximum of about \$5,600 (formerly the credit maximized at about \$5,000 with two children).

- Also, the starting and ending income phase-out amounts for married couples filing joint returns are increased, with the EIC now extending to about \$45,000 of income for those with two or more children.
- Effective for tax years beginning in 2009 and 2010.

Expanded Child Tax Credit

The floor of eligibility for the refundable \$1,000 child tax credit (i.e. refundable to the extent of 15% of the taxpayers earned income in excess of a threshold) was \$8,500 for 2008. The threshold is lowered to \$3,000 for 2009 and 2010.

Enhancement of Hope Credit

For 2009 and 2010, the Hope Credit is enhanced – available for the first four years of college and to a maximum of \$2,500 of credit for each year (formerly first 2 years only and \$1,800 maximum credit).

- The credit is 100% of the first \$2,000 of tuition and related expenses and 25% of the next \$2,000 of tuition and related expenses paid each year.

Phases out at AGI of \$80,000-\$90,000 on a single return and \$160,000-\$180,000 on a joint return.

The Learning Curve

Keeping you on the road to financial health

- The former Hope Credit and the continuing Lifetime Learning Credit phase out at AGI of \$50,000-\$60,000 single and \$100,000-\$120,000 joint.

Also, 40% of the enhanced credit exceeding the tax liability (both regular tax and AMT) is refundable to the taxpayer, unless the taxpayer is an 18-23 year old who would be subject to Kiddie Tax.

The definition of “education and related expenses” is expanded to include “course materials.”

Section 529 Plan Qualified Expenditures Includes Computers

For expenditures incurred in taxable years beginning in 2009 and 2010, computer technology and computer equipment qualify as education expenses for tax-free distributions from Sec. 529 plans.

Unemployment Compensation

The first \$2,400 of unemployment benefits received by an individual is tax-free for amounts received in 2009.

Extender Provisions

Some important provisions were extended:

- The 2009 AMT “patch”, increases the taxpayer AMT exemption to \$46,700 for single filers and \$70,950 for joint filers. Increases are just to match inflation, but at least we won’t be left in limbo this year.
- Personal tax credits are allowed as an offset against both regular tax and AMT through 2009.

AMT Exemption for Private Activity Bond Interest

Tax exempt interest income on private activity bonds issued in 2009 and 2010 is not a tax preference for AMT purposes.

Deduction for Sales Tax on New Motor Vehicle Purchases

The Learning Curve

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Taxpayers can now take a Schedule A itemized deduction for state or local sales and excise taxes paid on the purchase of a qualified motor vehicle from February 17, 2009 through December 31, 2009.

- Limited to the amount of tax paid on the purchase price of a qualified vehicle up to \$49,500.
- Phased out as a taxpayer's modified AGI increases from \$125,000-\$135,000 on a single return and \$250,000-\$260,000 on a joint return.
- Taxpayers who elect to deduct sales taxes instead of income taxes on Schedule A are not eligible for this new motor vehicle sales tax deduction, preventing a double deduction for the same amount.
- Since there is no dollar limitation for the sales tax deduction on Schedule A, some taxpayers may get more benefit from deducting sales tax instead of income tax on Schedule A, rather than deducting income tax on Schedule A and using the new motor vehicle sales tax deduction.

Example of phase-out of deduction based on AGI: A single taxpayer purchases a new automobile for \$30,000, with a 5% sales tax paid on the purchase ($\$30,000 \times 5\% = \$1,500$ of sales tax). Taxpayer's modified AGI is \$130,000. The limitation on the purchase price of the vehicle does not apply, but taxpayer's AGI exceeds \$125,000 by \$5,000, so the motor vehicle sales tax deduction is reduced by \$750 ($\$1,500 \times \$5,000/\$10,000$). Accordingly, taxpayer may only claim a \$750 motor vehicle sales tax deduction.

Example of income tax vs. sales tax deduction on Schedule A: Taxpayer's deduction for income tax on Schedule A would be \$2,000, but his total sales tax paid during the year is \$2,500, including \$1,250 on the purchase of a new motor vehicle. For 2008, taxpayer would have elected to deduct the total sales tax of \$2,500 on

The Learning Curve

Keeping you on the road to financial health

Schedule A instead of the income tax of \$2,000. Under this new provision, taxpayer is best served by taking the \$2,000 income tax deduction on Schedule A, along with the \$1,250 separate sales tax deduction on the purchase of the motor vehicle.

- A qualified motor vehicle includes a passenger automobile or light truck with a gross vehicle weight rating of not more than 8,500 pounds, and motorcycles and motor homes.
 - To qualify for the deduction, taxpayer must be the original user of the vehicle.
- Taxpayers not itemizing are allowed to increase the standard deduction by the motor vehicle sales tax deduction on Schedule A.
 - Whether claimed as part of the standard deduction or as an itemized deduction, the sales tax amount is allowed as a deduction for AMT purposes.

Economic Recovery Payments for Retirees

A one-time Economic Recovery Payment of \$250 is made to taxpayers who are eligible for Social Security benefits, Railroad Retirement benefits, or Veteran's compensation or pension benefits, or individuals eligible for SSI benefits. Checks should have been issued by mid-June 2009.

- Taxpayer needed to be eligible for at least one of these programs during November 2008, December 2008, or January 2009.
- Must reside within the U.S. 50 states, DC, Puerto Rico, Guam, Virgin Islands, American Samoa, or the Northern Mariana Islands.

Additionally, a \$250 refundable tax return credit (\$500 on a joint return where both spouses are eligible) is allowed for 2009 for individuals receiving a government pension or annuity from work not covered by Social Security and who were not eligible to receive the payment described in the previous paragraph.

The Learning Curve

Keeping you on the road to financial health

Taxpayers receiving these payments or credits are required to reduce the “Making Work Pay” credit by the amount received under this provision.

Reduction in 2009 Estimated Tax Payments

Qualified individuals can reduce the required annual estimated tax payment for taxable years beginning in 2009 to 90% of the tax liability shown on the return for the preceding taxable year, instead of 110%.

- Affects small business owners with AGI over \$150,000.
- The AGI of the taxpayer for the preceding taxable year must be less than \$500,000 (\$250,000 if MFS) and the taxpayer must certify that at least 50% of the gross income shown on the return was income derived from a small trade or business.
- A small trade or business is defined as any business employing no more than 500 persons, on average, during the calendar year ending in or with the preceding taxable year.

Transportation Fringe Benefits

The maximum monthly exclusion for employer-provided transit passes and vanpool benefits (previously \$120 per month for 2009) is increased to \$230, effective for March, 2009 through December, 2010.

The Learning Curve

Keeping you on the road to financial health

Energy Provisions

Principal Residence Energy Credits

The principal residence energy credit of IRC Sec. 25C is extended for energy-efficient improvements to homes through 2010.

- Credit is increased from 10% to 30% of the amount paid or incurred by a taxpayer for qualified energy efficiency improvements during 2009 and 2010.
- Property-by-property dollar caps previously existing for the credit (e.g., \$50 for circulating fans, \$150 for furnaces, etc.) are eliminated and the aggregate amount of credits allowed for taxable years beginning in 2009 and in 2010 is increased from \$500 to \$1,500.

Numerous definitional changes are made to qualifying property (e.g., electric heat pumps, water heaters, qualified natural gas furnace, qualified natural gas hot water boiler, qualified propane furnace, qualified propane hot water boiler, qualified oil furnaces, qualified oil hot water boilers, and qualifying exterior windows, doors, and skylights).

Effectively, all principal residence energy property previously eligible for the \$50, \$150 or \$300 maximum credit amount becomes eligible for the 30% credit for expenditures on such property.

- The former \$500 lifetime cap (and the \$200 lifetime cap with respect to windows) are repealed, and replaced with a \$1,500 credit limit on property placed in service between January 1, 2009 and December 31, 2010.

Note: The IRS had previously released guidance related to the rules for eligible energy-efficient home improvements. Items which qualify as energy efficiency improvements to the building include:

The Learning Curve

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- An insulation material or system, including a vapor retarder or seal.
- An exterior window, skylight or door, other than a storm window or storm door.
- A storm window.
- A storm door that, in combination with a wood door, meets specified energy standards.
- A metal roof that has appropriate pigmented coatings designed to reduce the heat gain to the building.

Note: The credit for building components is only allowed for the cost of materials; amounts paid for on-site preparation, assembly or installations are not allowed. However, for property that previously qualified for the \$50, \$150 or \$300 maximum credit (e.g., electric heat pump water heater, electric heat pump, central air conditioner, etc.), expenditures for labor costs allocable to assembly and installation do qualify for the credit.

Credit limits for high-tech residence improvements (\$2,000 cap for solar panels for hot water heat and for geothermal heat pumps, \$4,000 for small wind turbine property) are eliminated, effective for tax years beginning after 2008.

Renewable Energy Production Tax Credit

The renewable energy electricity production tax credit is extended by modifying the placed-in-service date for wind facilities for three years through December 31, 2012, and for other qualifying facilities (e.g., closed-loop biomass; open-loop biomass; geothermal; small irrigation; hydropower; landfill gas; and waste-to-energy facilities) for three years through December 31, 2013.

Plug-in Electric Vehicle Credit

The plug-in electric vehicle credit enacted in late 2008 is modified by increasing the overall vehicle limitation from 250,000 to 500,000 vehicles.

The Learning Curve

Keeping you on the road to financial health

- Low speed vehicles (defined as “neighborhood electric vehicles” in the statute) are excluded from the normal credit, but such low-speed vehicles, plug-in motorcycles, and three-wheeled vehicles otherwise meeting the criteria of a qualified plug-in vehicle are allowed a new 10% credit, limited to \$2,500 maximum.
- For a two or three-wheeled vehicle, the credit applies to vehicles with a battery of at least 2.5 kilowatt hours of capacity, as opposed to the normal four kilowatt hour capacity requirement and a potential credit of \$7,500.
- Also, a new 10% credit, to a maximum credit of \$4,000, is added for the costs of converting a vehicle to plug-in electric status.

The changes are effective as of February 17, 2009 and do not apply to vehicles sold after December 31, 2011.

Alternative Motor Vehicle Credit Allowed Against AMT

In the past, the hybrid vehicle credit did not offset AMT.

Effective for taxable years beginning after December 31, 2008, the alternative motor vehicle credit is considered a personal credit allowed to offset both regular tax and alternative minimum tax.

Repeal of Credit Limit on Business Wind Turbine Property

The \$4,000 annual cap on small wind energy property is repealed, effective for property placed in service after 2008.

The credit is now an unlimited 30% of the expenditure.

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Resources for more information:

Dave Marrinson, dmarrinson@sdkcpa.com
612.332.9397

Susan Byrnes, sbyrnes@sdkcpa.com
612.332.9310

Laurie Waterman, lwaterman@sdkcpa.com
612.332.9305

Dick Ledin, rledin@sdkcpa.com
612.332.9330

Eric Wille, ewille@sdkcpa.com
612.332.9314

www.recovery.com