

How businesses are affected by tax changes in the American Recovery and Reinvestment Act of 2009

Dear Reader:

The American Recovery and Reinvestment Act of 2009 (commonly referred to as the Recovery Act), which was signed into law on Feb. 17, 2009, makes a number of beneficial changes for business. Here's a review of the more widely applicable provisions that could have an impact on you and your enterprise.

Liberal expensing limits continued for another year. The Recovery Act gave a one-year lease on life to enhanced expensing rules, which allow qualifying businesses the option to currently deduct the cost of business machinery and equipment, instead of recovering it via depreciation over a number of years. For tax years beginning in 2009, the maximum amount that a business may expense is \$250,000, and the expensing election begins to phase out when a business buys more than \$800,000 of expensing-eligible assets. These dollar limits are the same as those that were in effect for 2008. Had the Recovery Act not been passed and signed into law, these dollar limits would have dropped this year to \$133,000 and \$530,000 respectively.

Bonus first year depreciation extended for another year, too. Bonus depreciation was supposed to go off the books for most assets placed in service after 2008. Fortunately, the Recovery Act extends for another year the ability for businesses to take an extra "bonus" depreciation deduction for the first year new assets are placed in service. The bonus first-year depreciation deduction generally equals 50% of the cost of qualified property (most types of tangible personal property, certain improvements to leased real property, and most software) acquired and placed in service during 2009. Certain types of property with a long life, and certain types of aircraft, may be placed in service before Jan. 1, 2011, and still qualify for the 50% bonus first year depreciation allowance. Also, note that the otherwise allowable first-year depreciation deduction for business autos first placed in service in 2009 continues to be hiked by \$8,000 thanks to the Recovery Act.

Extended election to speed up recognition of accumulated AMT and R&D credits instead of claiming bonus and accelerated depreciation. Many corporations are struggling and can't make good use of the bonus and accelerated depreciation breaks. A law enacted last year gave such corporations an alternative tax break. Corporations with assets eligible for bonus depreciation and placed in service in 2008 after Mar. 31 (or placed in service during 2009 for certain aircraft and property with a long production period) could elect to decline bonus depreciation and accelerated depreciation for the bonus-depreciation-eligible assets and, instead, claim otherwise-deferred pre-2006 research tax credits and alternative minimum tax credits. The Recovery Act extends this election so that it is available for property placed in service in 2009 (or 2010 for certain aircraft and property with a long production period).

Deferred tax on debt forgiveness income when debt is repurchased. A business generally will wind up with debt discharge income if it repurchases its debt for less than the outstanding amount of the debt. For debt that's repurchased in 2009 or 2010, the Recovery Act permits the tax that's owed on such debt discharge income to be paid over five years, beginning with 2014.

Small businesses may elect longer NOL carryback period. In general, net operating losses (NOLs) may be carried back two years and forward 20 years (different rules apply for certain specialized types of losses). For NOLs arising in a tax year beginning or ending in

2008, the Recovery Act permits small businesses to elect to increase the NOL carryback period from two years to three, four, or five years. A small business for this purpose 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 the three-tax-year period (or shorter period of existence) ending with the tax year in which the loss arose. The longer NOL carryback period gives small businesses that experienced losses the ability to get immediate refunds of income taxes paid in earlier years. The refunds can be used to fund capital investment or other expenses.

S corporation built-in gain holding period shortened temporarily. An S corporation generally is not subject to tax; instead, it passes through its income or loss items to its shareholders, who pay tax on their pro-rata shares of the S corporation's income. However, if a business that was formed as a C corporation elects to become an S corporation, the S corporation is taxed at the highest corporate rate (currently 35%) on all gains that were "built-in" at the time of the election if the gains are recognized during a special holding period. This holding period is the first ten S corporation years. (Similar rules apply if an S corporation receives property from a C corporation in certain nontaxable transfers.) Thanks to the Recovery Act, for tax years beginning in 2009 and 2010, the special holding period is shortened to seven years.

Bigger exclusion for sale of qualified small business stock. Before the Recovery Act, individuals could exclude 50% of their gain on the sale of qualified small business stock (QSBS) held for at least five years (60% for certain empowerment zone businesses). To qualify, QSBS must meet a number of conditions (e.g., it must be stock of a corporation that has gross assets that don't exceed \$50 million and that meets active business requirements). Under the Recovery Act, the percentage exclusion for gain on QSBS sold by an individual increases to 75% for stock acquired after Feb. 17, 2009 and before Jan. 1, 2011.

Reduced estimated taxes in 2009 for individuals with small businesses. To the extent that tax isn't collected through withholding, individuals generally must make quarterly estimated payments of the "required annual payment." The required annual payment is the lesser of: (1) 90% of the tax shown on the return or (2) 100% of the tax shown on the preceding year's return (110% if adjusted gross income (AGI) for the preceding year exceeded \$150,000). The Recovery Act provides that for a tax year beginning in 2009, the required annual payment for individuals with small businesses is the lesser of (1) 90% of the tax shown on the return for the tax year, or (2) 90% of the tax shown for the preceding tax year. An individual qualifies for this relaxed estimated tax payment rule only if: AGI on the preceding year's return is less than \$500,000 (\$250,000 if married filing separately); and at least 50% of the gross income shown on the previous year's return was from a small trade or business (one that employed no more than 500 people, on average, during the calendar year ending in or with the preceding tax year).

More workers eligible for work opportunity tax credit (WOTC). Employers that hire workers from one or more targeted groups (e.g., long term family assistance recipients) can claim a tax credit that varies with the type of person hired. For individuals beginning work for the employer after Dec. 31, 2008, the Recovery Act creates a new targeted group for the WOTC, consisting of unemployed veterans and disconnected youth who begin work for the employer in 2009 or 2010.

Limited subsidy for COBRA continuation coverage. The Recovery Act provides a 65% subsidy for COBRA continuation premiums for up to 9 months for workers who have been involuntarily terminated, and for their families. This applies to group health plans that are subject to the Federal COBRA continuation coverage requirements or to similar requirements under State law. If your company has such a plan, and receives a 35%

payment from someone eligible for the subsidy, it must make the remaining 65% premium payment. However, the company is "paid back." It can either offset its payroll tax deposits or claim the subsidy as an overpayment at the end of the payroll quarter.

To qualify for premium assistance, a worker must be involuntarily terminated between Sept. 1, 2008 and Dec. 31, 2009. Workers who were involuntarily terminated between Sept. 1, 2008 and Feb. 17, 2009, but failed to initially elect COBRA because it was unaffordable, must be given an additional 60 days to elect COBRA and receive the subsidy. Terminated workers must be notified of their right to a COBRA continuation coverage subsidy. The subsidy is not taxable when received, but higher income recipients—those with modified adjusted gross income above \$125,000 (\$250,000 for joint filers)—will have to pay back part or all of it at tax return time.

Expanded fringe benefit. For months beginning on or after Mar. 1, 2009 and before Jan. 1, 2011, the Recovery Act increases the monthly exclusion for employer-provided transit and vanpool fringe benefits from \$120 to \$230. This figure is adjusted for inflation each year and could go up in 2010.

