

## **A CHICKEN IN EVERY POT? (OR HOW THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009 MAY PROVIDE TAX BENEFITS)**

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The American Recovery and Reinvestment Act of 2009 (the “Act”) signed into law on February 17, 2009 by President Obama creates several tax incentives for small businesses and individuals. The Act is a \$780 billion package, roughly thirty-five percent (35%) of which is devoted to tax cuts designed to bolster the economy and reverse the recent downward trends. This article will highlight many of the tax provisions affecting small businesses and individuals.

### **Tax Provisions Affecting Small Businesses**

#### *Bonus Depreciation and Expanded Expensing for Certain Depreciable Assets*

The 2008 Economic Stimulus Act created what is known as “bonus depreciation.” Bonus depreciation allows an additional first year depreciation deduction equal to fifty percent (50%) of the adjusted basis of certain qualified property in the year of purchase. The Act extends bonus depreciation for an additional year, so that it applies to qualified property purchased in 2009.

The Act extends acceleration deductions for capital expenditures incurred in 2009. Small businesses can deduct up to \$250,000 of any Internal Revenue Code §179 property placed in service in 2009. Internal Revenue Code §179 defines such property as any tangible, depreciable, personal property which is acquired for use in the active conduct of a trade or business. The deduction is reduced dollar for dollar to the extent that the cost of the property placed in service exceeds \$800,000. This is an increase from the prior threshold of \$500,000.

#### *Deferring Cancellation of Indebtedness Income*

In most situations, a taxpayer recognizes ordinary income upon a cancellation of debt (“COD”). Pursuant to the Act, a taxpayer may elect to defer tax on the recognition of COD income from a “reacquisition” of an “applicable debt instrument” in 2009 or 2010 over a five (5) taxable-year period beginning in 2014. The newly enacted provision does not provide for an exclusion from income. It, instead, allows the taxpayer to defer paying the tax on the COD income until the tax years beginning in 2014 and ending in 2018.

#### *Net Operating Losses*

Taxpayers may carry a net operating loss (“NOL”) back two (2) years and then forward a maximum of twenty (20) years until the NOL is exhausted. The Act allows eligible small businesses to elect to carry back a NOL up to five (5) years. An eligible small

business is a corporation or partnership with average annual gross receipts of less than \$5,000,000 during the last three (3) taxable years, prior to the current taxable year.

The Service recently issued guidance on making the election to carry back a 2008 NOL for a period of either three (3), four (4), or five (5) years to offset taxable income in those preceding taxable years. Taxpayers are advised to elect the carryback on a timely filed income tax return for the taxable year in which the 2008 NOL arises and by specifying the length of the NOL carryback period elected (3, 4 or 5 years). Alternatively, the taxpayer may make the proper election by filing the appropriate form (Form 2045 for individuals, Form 1139 for Corporations and Form 1045 for estates and trusts) within six (6) months after April 17, 2009.

#### *Reduction in Built-in-Gains*

When a C corporation with earnings and profits elects S status, any built-in gain recognized during the ten (10)-year recognition period after the S election is initially made triggers a thirty-five percent (35%) built-in gains tax. Built in gain is the excess of the Fair Market Value of the corporation's assets over the tax basis of the assets on the day the corporation elects S status. This provision is designed to prevent C corporations from electing S status shortly before a major asset sale transaction to avoid the C corporation level tax. The Act provides that for taxable years 2009 or 2010, if the taxpayer is in the eighth, ninth or tenth year of the ten (10)-year recognition period, no built-in gains tax will apply to asset dispositions that otherwise would have triggered the built-in gains tax.

#### *Energy Efficient Tax Credits*

The Act provides that taxpayers who install solar energy systems (including solar water heating and solar electric systems), small wind systems, geothermal heat pumps, and fuel cell and micro turbine systems can receive a thirty percent (30%) tax credit for systems placed in service before December 31, 2016; the previous tax credit cap no longer applies.

### **Tax Provisions Affecting Individuals**

#### *Education Related Credits*

The Act allows a tax credit of up to \$2,500 for the cost of tuition and related expenses paid during the year. The credit phases out for taxpayers with adjusted gross income in excess of \$80,000 (\$160,000 in case of a joint return).

Internal Revenue Code §529 allows prepayment of higher education costs on a tax-favored basis. Under Internal Revenue Code § 529 plan rules, distributions from the plan are tax-free if they do not exceed the student's qualified higher education expenses. These include tuition, fees, books, supplies, room and board and required equipment. The Act expands the definition of qualified expenses that can be paid from such plans to include computers and other related technology expenses.

### *First Time Homebuyers*

The Act allows for a refundable tax credit for first-time homebuyers up to \$8,000. The credit is available for homes purchased prior to December 1, 2009. The credit phases out for taxpayers with adjusted gross income in excess of \$75,000 (\$150,000 for joint returns). The taxpayer will be required to repay the tax credit if the taxpayer fails to occupy the home for at least three (3) years. The repayment will be due on the tax return for the year in which the home is sold or ceases to be used as a principal residence.

### *New Vehicle Purchases*

The Act provides a deduction for state and local sales and excise taxes paid on the purchase of new cars, light trucks, motor homes and motorcycles after February 16, 2009 and prior to December 31, 2009. The deduction is available regardless of whether a taxpayer itemizes deductions on Schedule A. The deduction is limited to tax paid on up to \$49,500 of the purchase price of eligible motor vehicles.

### *Energy Efficient Improvements*

The Act provides that individuals can receive a tax credit equal to thirty percent (30%) of the cost of qualified energy-efficient improvements, up to \$1,500, during 2009 and 2010. Qualified energy efficient improvements include (but are not limited to) the installation of energy-efficient main-air circulating fans, energy-efficient natural gas, propane, or oil furnaces, hot-water heaters, heat pumps, air conditioners, energy-tight windows, and more insulation.

### *Sale of Small Business Stock*

Under prior law, Internal Revenue Code §1201 provided a fifty percent (50%) exclusion for gain from the sale or exchange of qualified small business stock held for more than five (5) years, subject to certain other limitations. The Act increases to seventy-five percent (75%) the amount of gain excludable from the sale or exchange of qualified small business stock prior to December 31, 2010.

### *Decreased Estimated Tax Payment Requirements*

The Act reduces the estimated tax requirements for 2009 for qualified individuals to the lesser of ninety percent (90%) of the tax shown on the return for the tax year or ninety percent (90%) of the tax shown on the preceding year's return. A qualified individual is any individual with an adjusted gross income of less than \$500,000 in the preceding tax year and who certifies that more than fifty percent (50%) of the gross income shown on that individual's return for the preceding year was income from a small business.

If you have any questions concerning how the American Recovery and Reinvestment Act of 2009 may offer you tax benefits, or if you have any other tax-related needs, please contact Zachary Conjeski (at 410-694-1240 or [zconjeski@rosenbergmartin.com](mailto:zconjeski@rosenbergmartin.com)) or any attorney in our tax group:

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