

FEDERAL TAX LAW CHANGES

The American Recovery and Reinvestment Tax Act of 2009 contains some much needed tax relief and tax incentives. The below article is a summary of the full article on our website, entitled “CCH Tax Briefing: American Recovery and Reinvestment Act of 2009 Special Report.” As always, we look forward to answering all of your specific questions as they relate to you and your business.

The *American Recovery and Reinvestment Tax Act of 2009* was recently signed by President Obama. The \$787 billion new law, which contains nearly \$300 billion in tax relief, sets in motion a wave of direct spending and tax incentives to jump start the U.S. economy out of recession. The tax provisions add many new tax breaks and significant enhancements to existing deductions and credits. Major provisions include new COBRA benefits, enhancements to the child tax credit and education credit, a 2009 alternative minimum tax (AMT) patch, extensions of 2008 bonus depreciation and increased Code Sec. 179 expensing, along with a five-year net operating loss (NOL) carry back for small businesses, and more. In all, the new law makes over 300 changes to the Internal Revenue Code.

One of the most talked about changes applies to COBRA Benefits:

COBRA Benefits The new law allows an individual who is involuntarily separated from employment between September 1, 2008, and January 1, 2010, to elect to pay 35 percent of his/her COBRA coverage and have it treated as paying the full amount.

The former employer will be required to pay the remaining 65 percent but, in effect, will be reimbursed by crediting those amounts against income tax withholding and payroll taxes it is otherwise required to remit to the federal government. Income and other limitations on COBRA coverage apply.

The new law provides a Special Election Period for those individuals who are eligible, but did not originally elect COBRA benefits. Employers are required to inform these individuals of this opportunity which begins February 17, 2009, and ends 60 days after the notice of the Special Election Period is provided to the individual. If a former employee elects COBRA benefits during this Special Election Period, they will begin coverage with the first period of coverage beginning after February 17, 2009 (March 1 for employers with monthly coverage periods). The COBRA continuation coverage will end no later than the day the COBRA continuation coverage would have ended if the employee had originally elected COBRA based on the date of the original qualifying event, absent the Special Election Period.

In connection with providing the subsidy and offering the Special Election Period, employers are required to notify individuals terminated between September 1, 2008 and December 31, 2008 about the availability of the subsidy, the availability of any lower-cost health plan options and the availability of the Special Election Period. Additionally, the employer is

required to inform such individuals of their responsibility to notify the group health plan administrator of eligibility under another group health plan or Medicare, and the penalty for failure to provide such notice.

Here are quick summaries of a few of the other changes imposed by the new laws:

INDIVIDUAL INCENTIVES

Making Work Pay Credit Making Work Pay credit allows 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). The credit applies retroactively to the start of 2009 and will be repeated again in 2010. The credit applies in full for individuals whose modified adjusted gross income (MAGI) does not exceed \$75,000 or \$150,000 in the case of married couples filing jointly. The credit is phased out at a two percent rate above that limit.

The employer's share of FICA, or its 6.2 percent equivalent to be more precise, would remain unchanged. Qualified taxpayers would take this credit through a reduction in wage withholding or in a lump sum when filing their returns for the tax year. Earnings from self-employment also qualify to the extent they are taken into account in computing taxable income. Individuals who do not provide a Social Security number on their returns, however, are ineligible.

AMT Patch The new law includes an alternative minimum tax (AMT) patch for 2009, which raises exemption amounts slightly above the 2008 patch levels. The 2009 AMT exemption amounts are: \$70,950 for joint filers and surviving spouses (up from \$69,950 in 2008); and \$46,700 for singles and heads of households (up from \$46,200).

Education Credit The new law temporarily enhances the existing HOPE education credit—for 2009 and 2010 only, and renames it the “American Opportunity Tax Credit.” Under the new credit, the maximum \$2,500 per year would be allowed on \$4,000 in qualifying payments (100 percent of the first \$2,000 and 25 percent of the next \$2,000). In scope the law extends the credit to all four years of college, adding course materials to qualifying expenses, as well as extending the phase-out level to \$80,000/\$160,000 joint filers.

Child Tax Credit The new law increases the refundable portion of the child tax credit for 2009 and 2010. The agreement does so by setting the income threshold at \$3,000. The child tax credit currently gives individuals with dependent children under age 17 at the close of a calendar year a \$1,000 per child credit through 2010.

BUSINESS INCENTIVES

Bonus Depreciation The new law extends the 50-percent first-year bonus depreciation allowed under the *2008 Economic Stimulus Act* through December 31, 2009, retroactive to January 1, 2009. The new law also extends, through 2010, the additional year of bonus depreciation allowed under the *2008 Economic Stimulus Act* for property with a recovery period of 10 years

or longer, for transportation property (tangible personal property used to transport people or property), and for certain aircraft. This bonus depreciation is taken on top of the regular depreciation reported for the year the property is placed in service. As with any accelerated depreciation, however, a large current depreciation deduction results in smaller future deductions.

Also extended for bonus depreciation purposes, the regular dollar cap for new vehicles placed in service in 2009 is raised again by \$8,000, effective January 1, 2009. For 2008, the regular first-year depreciation dollar cap of \$2,960 for autos was raised to \$10,960, if bonus depreciation is elected (\$11,160 for light trucks and vans).

Code Sec. 179 Expensing The new law extends the increased 2008 Code Sec. 179 expensing (aka, small business expensing) amounts to 2009. The *2008 Economic Stimulus Act* increased the amount of Code Sec. 179 expensing for 2008 to \$250,000 and increased the threshold for reducing the deduction to \$800,000. Without the 2009 extension, businesses placing property in service in 2009 would have been limited to a \$125,000 inflation adjusted maximum deduction with a \$500,000 cap.

NOL Carryback The new law provides a five-year carryback of 2008 NOLs but only for qualified small businesses with average gross receipts of \$15 million or less. The new law gives these businesses the choice to carry back NOLs three, four or five years. The new treatment will apply only to NOLs for any tax year beginning or ending in 2008. The normal NOL carryback period, which is two years for all businesses, returns for NOLs incurred in 2009. As soon as a taxpayer has filed a 2008 return containing an NOL, it can begin the process of claiming a refund to get cash back into its pockets.

Refundable Credits in Lieu of Bonus Depreciation The new law allows businesses to monetize accumulated AMT and R&D credits in lieu of taking bonus depreciation. The election to accelerate these historic AMT and R&D credits originally applied only to 2008, but the new law extends this option to all property qualifying for bonus depreciation placed in service through 2009. The new law also allows a business to change its election from 2008 to 2009, or to make an election in 2009 when no election was made in 2008. This is a sharp difference from recent regulatory guidance issued by the IRS that would make a 2008 election binding on the business for 2009.

Cancellation of Indebtedness The new law will allow certain businesses to elect to recognize cancellation of indebtedness income over five years, beginning in 2014, for specified types of business debt repurchased by the business after December 31, 2008, and before January 1, 2011. An applicable debt instrument under the new law means a bond, debenture, note, certificate, or any other instrument constituting indebtedness issued by a C corporation or any other "person" in connection with the conduct of a trade or business by such person. Once made, the election is irrevocable. The new law further provides for acceleration of deferred items in triggering circumstances, such as the liquidation or sale of substantially all of the assets of the taxpayer or the cessation of business by the taxpayer.

Qualified Small Business Stock Under the new law, the investor exclusion increased from 50 percent to 75 percent of the gain from the sale of certain small business stock acquired and held for more than five years after the date of enactment and before January 1, 2011. A small business cannot have assets over \$50 million and must conduct an active trade or business.

S Corp Built-In Gain Period The new law temporarily shortens, from 10 to seven years, the holding period for assets subject to the built-in gains tax imposed after a C corp elects to become an S corp. This provision applies to S corps that recognize built-in gain in tax years beginning in 2009 and 2010. The built-in gains tax prevents C corps from avoiding corporate level tax on the disposition of appreciated assets it acquired while a C corp by first converting to S status. However, these rules also discourage S conversions in situations in which the business may not survive under C corp rules. The new law will give shareholders more flexibility during the current economic crisis.

Estimated Taxes The new law decreases required estimated tax payments for individuals whose incomes primarily come from a small business in 2009. Rather than being required to make quarterly estimated tax payments based on 100 percent of their 2008 returns, the new law allows computation based on 90 percent.

Caution: This article is meant for general information only. Since every situation is unique we strongly advise you to seek guidance from a professional. As always, we look forward to discussing these matters with you. Please feel free to contact us with any specific questions you have at: partners@sharkcpa.com or (508) 584-2120.