



Middle class, small businesses benefit most

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Stimulus act brings \$300 billion in tax relief

President Obama signed *The American Recovery and Reinvestment Act of 2009* on Feb. 17, 2009. The act is the tax portion of the \$789 billion stimulus package that has been so hotly debated in Congress and the news in recent weeks.

The act provides nearly \$300 billion in tax relief for tax years 2009 and 2010. Many of the tax provisions are retroactive to Jan. 1, 2009, and are intended to provide immediate tax relief to middle-class American citizens and small businesses. If you have questions about your particular situation, please call our office.

INDIVIDUAL INCENTIVES

Making Work Pay tax credit

The Making Work Pay tax credit is, by far, the largest tax provision of the stimulus package, with an estimated cost of \$116 billion.

The Making Work Pay tax credit allows a credit against income tax for the lesser of 6.2 percent of an individual's earned income or \$400 (\$800 for married couples filing jointly). The credit begins to phase out when an individual's modified adjusted gross income exceeds \$75,000 (\$150,000 for married couples filing jointly). The credit applies to 2009 and 2010 tax returns.

The benefit of the credit can be claimed in advance through reduced withholdings or as a reduction of tax on your 2009 tax return.

The IRS has issued new withholding tables that employers will use starting this spring.

If the figure of 6.2 percent of an individual's income sounds familiar, it should. That is the rate at which Social Security tax is withheld from employees' paychecks. Basically, the credit is a refund of Social Security tax on the first \$6,452 (\$12,904 for couples) of earned income. However, the employer's share of FICA payments, or 6.2 percent of earned income, does not change.

Observation: The Making Work Pay tax credit is available only to individuals with earned income. The credit is not available for nonresident aliens, estates or trusts or those who may be claimed as dependents.

Note: This provision provides an opportunity for business owners to hire their adult children so the credit will also become available to them. There are even more opportunities if the adult children contribute earnings to a Roth IRA.

Earned income credit

The new act enhances the earned income credit for 2009 and 2010 by increasing the percentage from 40 to 45 percent of the first \$12,750 of earned income for taxpayers with three or more children. The phaseout range has been increased by \$1,880 for joint filers to eliminate any marriage penalty.

Child tax credit

The new act increases the refundable part of the child tax credit for 2009 and 2010 by reducing the floor for the calculation on earned income from \$8,500 to \$3,000.

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A tax information bulletin to our clients and business associates from:

American Opportunity Tax Credit

The former Hope credit for payment of higher education expenses is expanded and renamed the American Opportunity Tax Credit. It increases the current credit from a maximum of \$1,800 to \$2,500 (the first \$2,000 of qualifying expenses plus 25 percent of the next \$2,000) and is available annually for 2009 and 2010. It also covers four years of educational expenses instead of two.

The credit phases out completely for individuals with a modified adjusted gross income of more than \$80,000 (\$160,000 for joint filers). It can be used to reduce income for both regular and alternative minimum tax purposes. Only 40 percent of the credit is refundable. The Lifetime Learning Credit, available for a broader range of education, is still available.

Observation: Although the American Opportunity Tax Credit applies retroactively to payments made for semesters beginning in 2009, it applies only to payments made in 2009. If payments for 2009 were paid in 2008, the old rules apply.

COBRA subsidy for involuntarily terminated workers

When employees are terminated from their jobs, they are currently entitled to continue on the employers' health insurance plan at their own expense for a period of 18 months.

The new legislation provides that workers who were involuntarily terminated between Sept. 1, 2008, and Dec. 31, 2009, will receive a 65 percent federal COBRA premium subsidy for up to nine months. The subsidy is provided by the government – not the employer. The employer recoups the discounted amount in a reduction of payroll taxes remitted.

The COBRA subsidy is phased out for taxpayers with modified adjusted gross incomes between \$125,000 and \$145,000 (\$250,000 and \$290,000 for those filing jointly). Any subsidies paid will be recaptured on the taxpayers' tax returns.

Residential energy property credit

The residential energy property credit was due to expire at the end of 2009. The new act extends the credit through 2010 and increases the credit percentage from 10 to 30 percent for 2009 and 2010. The maximum credit is also increased from \$500 to \$1,500. The law also removes the dollar cap for the building envelope, solar hot water property, geothermal heat pumps and wind energy property. Certain standards for the property apply. The new law also increases the required energy savings for taxpayers to be able to take the credits.

Observation: Taxpayers who took advantage of the \$500 credit previously available will still have an additional \$1,500 credit available through 2010.

Unemployment benefits

The amount of unemployment benefits is increased by \$25 per week, with 46 weeks of eligibility. Additionally, the first \$2,400 of benefits in 2009 will not be subject to federal income tax.

Alternative minimum tax exemption

The alternative minimum tax (AMT) was established to prevent wealthy families and individuals from avoiding paying income tax. However, the exemption from the AMT was never indexed for inflation, and when individual income tax rates were lowered, the AMT rate remained the same, causing many more taxpayers to become subject to the AMT. To remedy this, Congress passed temporary legislation that increased the exemption amount each year over the last few years.

For 2009, the AMT exemption rate is increased to \$46,700 for individuals (\$70,950 for joint filers).

Note: This one-year patch has an estimated cost of \$70 billion and is expected to protect as many as 26 million taxpayers from the AMT.

First-time home buyer credit

The first-time home buyer credit that was passed last year just got much better. Now, the refundable credit is increased to the lesser of 10 percent of the purchase price of a principal residence – or \$8,000. The phaseout of the credit for taxpayers with adjusted gross incomes in excess of \$75,000 (\$150,000 for joint filers) remains.

And now, for purchases made after Dec. 31, 2008, and before Dec. 1, 2009, the credit does not have to be repaid if the home buyer keeps the home for at least three years.

The old rules continue to apply to homes purchased between April 9, 2008, and Jan. 1, 2009.

Observation: Those qualifying for a first-time home buyer credit should adjust their withholdings or estimated tax payments.

Note: The first-time home buyer credit enhances an opportunity for parents or grandparents to gift money to their younger relatives to assist with the purchase of a home.

New car incentive

Individuals who do not itemize deductions but purchase a new car between Feb. 17, 2009, and Dec. 31, 2009, will receive an "above-the-line" deduction for state and local sales taxes. The deduction is limited to the first \$49,500 of the purchase price. The deduction begins to phase out for those with a modified adjusted gross income of \$125,000 (\$250,000 for joint filers).

Observation: A taxpayer who itemizes and deducts state and local income taxes is entitled to the above-the-line deduction. Those who elect to deduct sales taxes cannot double dip.

Note: The sales tax deduction does not apply for leased vehicles or for vehicles used for business.

Payments to taxpayers on fixed incomes

The new act provides a one-time payment of \$250 to retirees, disabled individuals and SSI recipients receiving benefits from the Social Security Administration, railroad retirement beneficiaries

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and disabled veterans. Retired government workers, many of whom did not participate in the Social Security system, are also eligible.

Observation: The act does not indicate how the \$250 will be paid to qualified recipients.

Build America bonds

The new act provides a new type of municipal bond – Build America bonds.

Unlike traditional municipal bonds, which many high net worth taxpayers use to minimize their taxes, the interest on these bonds is federally taxable. However, the investor receives a credit for 35 percent of the interest received. The credit can be used against both regular tax and AMT.

State and local governments can elect to have the bonds they issue before Jan. 1, 2011, treated as Build America bonds. This provision does not apply to private activity bonds.

Observation: Build America bonds can be especially effective for investors subject to the AMT. The 35 percent tax credit is higher than the maximum AMT rate of 28 percent.

Note: As with all investments, it is important to discuss the benefits of Build America bonds with your financial adviser.

Private activity bonds

Generally, private activity bonds (otherwise known as AMT bonds) pay a higher interest rate than other municipal bonds because the interest is treated as a tax preference item for AMT purposes. The new act eliminates the AMT tax preference for private activity bonds issued in 2009 and 2010.

BUSINESS INCENTIVES

Bonus depreciation and Code Section 179

Last year's stimulus legislation allowed businesses to take 50 percent bonus depreciation on qualifying assets and significantly increased smaller businesses' ability to expense asset acquisitions in the year they were placed in service.

The new act extends these provisions for purchases in 2009 for bonus depreciation and tax years beginning in 2009 for Code Sec. 179 deductions.

Observation: Bonus depreciation is only for new property placed in service. The Code Sec. 179 expensing election applies to both new and used property.

Low income housing credit

To stimulate construction, the federal government can make grants for low income housing projects in lieu of low income housing credit allocations in 2009.

Observation: Issuing grants instead of allowing credits should make the construction of projects easier because the developer will not have to find investors to purchase credits.

Reduced estimated taxes for small business owners

Qualified small business owners can pay estimated taxes for 2009 based on 90 percent of their 2008 income tax liability instead of 100 percent. Qualified owners must have less than \$500,000 in adjusted gross income, with at least 50 percent of their income derived from businesses with fewer than 500 employees.

Observation: Individuals with income above the \$500,000 threshold must still remit estimated taxes based on the lesser of 90 percent of their 2009 income tax liability or 110 percent of their 2008 income tax liability.

Cancellation of debt

The new legislation allows for recognition of cancellation of debt income for business to be postponed until 2014 when the debt is repurchased by the debtor. It will then be amortized ratably over five years. This provision applies to transactions after Dec. 31, 2008, and before Jan. 1, 2011. This is an irrevocable election.

Observation: The rules surrounding this provision are very complex. If you are contemplating postponing the recognition of cancellation of debt, please call our office.

Plug-in electric vehicles

The new legislation provides a base credit of \$2,500 – with a credit of between \$7,500 and \$15,000, depending on the weight of the vehicle – for the purchase of qualifying plug-in electric vehicles, although they are not currently available for purchase.

Net operating loss carryback

Earlier versions of the new legislation provided that the extended carryback period for net operating losses would be available for nearly all businesses.

As the bill was finally passed, only small businesses with three-year average gross receipts of \$15 million or less in years beginning or ending in 2008 would qualify. Qualifying businesses can elect to carry back their losses for three, four or five years.

S corporation built-in gains

One reason that many closely held businesses elect to be treated as S corporations is to avoid the double taxation that results from the sale of assets in a regular C corporation.

Once a corporation elects to be treated as an S corporation, it is still taxed on the gain that would have been recognized had it sold its assets for fair market value when it elected S corporation status (built-in gain) for a period of 10 years.

The new legislation reduces the built-in gain period from 10 to seven years.

Qualified small business stock

The exclusion for the gain on sale of qualified small business stock is increased from 50 percent to 75 percent for stock issued after Feb. 17, 2009, and before Jan. 1, 2011. To qualify, the stock must be held more than five years.

To be considered qualified small business stock, shares must

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be originally issued in exchange for money, property or services from a C corporation with assets of less than \$50 million that engages in an active trade or business.

Grants for renewable energy projects

The Secretary of the Treasury is authorized to provide a grant to each person who places specified energy property into service during 2009 or 2010. Grants also may be provided after 2010, but before the credit termination date, if construction for the property began during 2009 or 2010. The property must be either:

- ◆ An electricity production facility otherwise eligible for the renewable electricity credit
- ◆ Qualifying property otherwise eligible for the energy credit.

Observation: The grants are intended to make obtaining financing easier for these products.

New categories for Work Opportunity Credit

Two new categories are created for eligibility for the Work Opportunity Tax Credit: unemployed veterans and disconnected youth. They apply to new hires in 2009 and 2010.

Transit benefits parity

The new act increases the income exclusion amount for transit passes and van pooling expenses from \$120 to \$230 per month for 2009. The increase is effective beginning in March 2009 and continues through January 2010 with an inflation adjustment.

Observation: This is an increased tax-free fringe benefit if paid by the employer.

Withholding on government contractors

The 3 percent withholding on government contractors is delayed one year to Dec. 31, 2011.

CONCLUSION

While *The American Recovery and Reinvestment Act of 2009* covers many areas of tax law, we expect further tax legislation during the year, especially in the areas of estate and gift tax. As always, we will make you aware of any significant changes. If you have questions, please call our office. ■

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