TAX CHANGES IN THE FEDERAL ECONOMIC STIMULUS LEGISLATION

Client Advisories

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On February 17, 2009, the American Recovery and Reinvestment Act of 2009 was signed into law. The Act, also known as the federal Economic Stimulus Plan, contains approximately $300 billion in tax relief and incentives for renewable and clean energy investment.

PROVISIONS AFFECTING INDIVIDUALS

Making Work Pay Credit - The Act provides a refundable tax credit equal to 6.2% of earned income (up to a maximum of $400 for single filers and $800 for joint filers) for 2009 and 2010. "Earned Income" is, with certain modifications, essentially the same as "earned income" for purposes of the earned income tax credit. The credit begins phasing out once adjusted gross income ("AGI") exceeds $75,000 ($150,000 for joint filers). The credit may be claimed in the form of a reduction in withholding taxes or as a credit on the tax return.

Economic Recovery Payment - The Act provides a one-time payment of $250 (which would reduce the amount of the Making Work Pay Credit) to individuals receiving benefits from the Social Security Administration, Railroad Retirement beneficiaries and disabled veterans receiving benefits from the U.S. Department of Veterans Affairs. The recipient must have been eligible to receive those benefits in November or December of 2008 or January of 2009. The Act also provides a one-time refundable tax credit of $250 in 2009 to certain government retirees who are not eligible for Social Security benefits (this credit would also reduce the amount of the Making Work Pay Credit).

Earned Income Tax Credit Increase - The Act increases the Earned Income Tax Credit percentage for families with three or more qualifying children to 45% from 40% (filers with two children still get 40%) for tax years beginning in 2009 and 2010. Taxpayers with three or more qualifying children may, as a result, now claim a credit of 45% of earnings up to $12,570, resulting in a maximum credit of $5,656.50. The Act also provides relief to married couples filing jointly by increasing the threshold phase-out amount to $5,000 above the threshold phase-out amounts for singles, surviving spouses, and heads of households for 2009 and 2010, and this amount is also adjusted for inflation going forward.

Refundable Child Credit - For 2009 and 2010, the refundable child credit is equal to 15% of earned income in excess of $3,000. The previous threshold was $12,550.

Education Benefits - The Act contains several pro-taxpayer education provisions. (A) The first temporarily replaces the Hope Tax Credit and is called the American Opportunity Credit. It permits qualified taxpayers to take a credit up to $2,500 per eligible student per year for "qualified tuition and related expenses" for each of the first four years of the student's post-secondary education. "Qualified tuition and related expenses" now includes course materials. This credit may be applied against the Alternative Minimum Tax ("AMT"). The credit is phased out once AGI reaches $80,000 ($160,000 for joint filers). (B) The Act also modifies Section 529 by permitting the use of 529 monies to purchase computer equipment, internet access and related services if the equipment and services are to be used by the beneficiary or his family during any of the years the beneficiary is enrolled at an eligible educational institution.

Transportation Fringe Benefits - The Act expands the ability of employees to exclude qualified transportation fringe benefits from income by increasing the excludable amount of transit passes and vanpool benefits to the excludable amount for employer-provided parking.

First Time Home Buyer Credit - The Act increases and modifies the first time home buyer credit created in 2008, which provided a tax credit of 10% of the purchase price of a first home (up to $7,500) which was then ratably recaptured over the next fifteen years (effectively, a long-term interest free loan from the federal government). The new credit of 10% of the purchase price applies to purchases on or after January 1, 2009 - - it is now capped at $8,000, but perhaps most importantly, it is not recaptured unless the property is sold during the first 36 months of ownership.

New Car Credit - The Act provides a deduction for qualified motor vehicle taxes on purchases made on or after Feb. 17, 2009 and before Jan. 1, 2010. Taxpayers may now deduct the sales and other excise taxes incurred on the purchase of new passenger vehicles and motor homes (on purchase prices up to $49,500). The deduction is phased out for taxpayers with modified AGI of $125,000 ($250,000 for joint returns) and is allowed in determining one's AMT. The deduction is not available for taxpayers who elect to deduct state and local sales taxes instead of state and local income taxes.

Unemployment Benefits - The Act permits up to $2,400 of unemployment compensation benefits received in 2009 to be excluded from gross income (previously, the full amount of those benefits was includable in gross income).

AMT Patch - The Act increases the AMT exemption amounts to prevent some middle-income taxpayers from being subject to the AMT. The new limits are $46,700 (up from $46,200 in 2008) for unmarried individuals, $70,950 (up from $69,950 in 2008) for married couples filing a joint return and surviving spouses, and $35,475 (up from $34,975 in 2008) for married individuals filing separate returns. The "patch" also permits personal credits to be applied against the AMT.

BUSINESS PROVISIONS

Bonus Depreciation - The Act allows 50% of the cost of depreciable property acquired in 2009 and placed in service for use in the United States to be expensed immediately, instead of being depreciated over the useful life of the property. Because this provision is an extension of the 2008 economic stimulus bill, the bonus depreciation applies to property acquired after December 31, 2007, and placed into service in 2008, and before the end of 2009.

Small Business Provisions - The Act provides for several enhanced small business provisions:

1. The Act provides for the ability to claim an additional depreciation deduction for new company passenger automobiles (original use, and more than 50% of its use is in the trade or business).

2. Under Section 179, a taxpayer (other than an estate, trust, and certain noncorporate lessors) may elect to deduct as an expense, rather than to depreciate, up to a specified amount of the cost of new or used tangible personal property placed in service during the tax year in the taxpayer's trade or business. The Act provides for the extension of the provision in the 2008 economic stimulus which increased the maximum dollar cap for deduction under Section 179. The provision is applicable to property placed in service in 2008 and before 2010, thus permitting small and medium-sized businesses to recover the cost of capital investments more quickly. The Act also increased the annual maximum deduction for qualified capital improvements under Section 179 to $250,000, with an investment ceiling of $800,000 - - up from $100,000, with an investment ceiling of $600,000.

3. The Act allows small businesses (defined as businesses with average annual gross receipts of $15 million or less during a three-year period ending in the loss year) to carry back their net operating losses up to five years, rather than the existing two-year rule. The NOL must arise in tax years ending in 2008, which makes a difference for fiscal year tax payers that may have accrued a loss in calendar 2007.

4. The Act provides flexibility to individual taxpayers who are small business owners required to make quarterly estimated tax payments by lowering the required payment amount. A qualified individual is one who's AGI for the preceding tax year is less than $500,000 ($250,000 for a married individual filing separately), and the individual certifies that more than 50% of the gross income shown on the return for the preceding year was income from a small business. Income from a small business refers to a trade or business having up to 500 employees for the preceding tax year. The "required annual payment" (payable in quarterly installments) is now the lesser of 90% of the tax shown on the current year's tax return or 90% of the tax shown on the previous year's tax return for the taxpayers' tax year beginning in 2009.

5. The Act provides additional gain exclusion on the sale of "qualified small business stock" by individuals. Prior to the Act, an individual selling qualified small business stock could exclude 50% of the gain if the individual held the asset for more than five years. The Act increases the excludable portion to 75% of the gain realized.

Work Opportunity Tax Credit Extension - Businesses that hire individuals before September 2011 from one of nine targeted groups will be able to claim a tax credit equal to 40% of the first $6,000 of wages paid. The Act adds two additional targeted groups beginning work after December 31, 2008: unemployed veterans and disconnected youth who begin work for the employer in 2009 or 2010. An "unemployed veteran" (a) is an individual who has served on active duty in the Armed Forces for more than 180 days or was discharged from active duty for a service-related disability, (b) is an individual who was discharged from active duty at any time during the five-year period ending on their hiring date, or (c) an individual described in (a) or (b) above who has received unemployment compensation for not less than four weeks during the one-year period ending on the hiring date. A “disconnected youth” is an individual who is (a) between 16 and 25 years old on the hiring date, (b) not regularly attending any secondary, technical or post-secondary school during the six-month period preceding the hiring date, (c) not regularly employed during the six-month period preceding the hiring date, and (d) not “readily employable by reason of lacking a sufficient number of skills.”

Modification of Discharge of Indebtedness Income - Businesses that purchase their debt obligations from holders at a price that is less than the “adjusted issue price” of the debt instrument realize discharge of indebtedness income equal to the excess of the adjusted issue price over the actual price paid for the debt instrument. The Act permits a business that retires its debt for a price that is less than the adjusted issue price after December 31, 2008, and before January 1, 2011, to include the income portion in gross income ratably over five years beginning in the fifth year following the debt’s retirement (if the business retires its debt by repurchasing it for less than the adjusted issue price in 2009), or beginning in the fourth year following the retirement of the debt if the business’s repurchase occurs in 2010.

S Corporation Holding Period Reduction - For tax years beginning in 2009 and 2010, the Act reduces the holding period for taxation of built-in gains on S corporation assets to seven years from 10 years, and no tax will be imposed on the built-in gain if the seventh tax year in the recognition period preceded 2009 and 2010.

Section 382 Loss Limitations - The Act effectively repeals Notice 2008-83, which permitted a bank’s losses on loans or bad debts to not be treated as pre-ownership change losses, which under Section 382 would have limited the usefulness of the losses. The Act makes the Notice applicable, with very limited exceptions, to ownership changes for a bank occurring before January 16, 2009. The Act also suspends the Section 382 change in ownership loss limitation rules where an “ownership change” occurs in the context of the Troubled Asset Relief Program.

Bonus and Accelerated Depreciation for Accumulated Credits - The Act extends for 2009 a provision of the Foreclosure Prevention Act of 2008, which permits corporate AMT taxpayers and loss taxpayers in 2009 to receive the present allowance (20% of the value of accumulated AMT or Research and Development credits), as a refundable tax credit, of otherwise-deferred “pre-2006 credits.”

RENEWABLE AND CLEAN ENERGY PROVISIONS

Extended Renewable Electricity Production Credit - The Act extends for three years through 2013 (2012 for wind facilities) the period during which qualified facilities may be placed in service. The credit is allowed for electricity produced from wind, closed-loop biomass, open-loop biomass, geothermal energy, municipal solid waste, qualified hydropower production, marine and hydrokinetic renewables and solar energy. The Act also provides a new 30% credit available for investment in qualified property used in a qualified advanced energy manufacturing project (electricity production and transmission).

Election of Investment Credit Instead of Renewable Energy Production Credit - The Act permits taxpayers to make an election to take a 30% investment credit for a qualified energy producing facility placed in service after December 31, 2008. And for periods after December 31, 2008, the Act eliminates the credit cap applicable to qualified small wind energy properties and repeals the basis reduction requirement for subsidized energy financing.

Primary Residence Energy Credits - The Act extends the energy tax credits available to individuals for energy efficiency improvements made to their primary residences by 2011. Beginning after December 31, 2008 and for property placed in service before 2011, the Act increases the 10% credit (for the cost of efficient insulation materials) to 30%, and all property otherwise eligible for the $50, $100, or $150 credits (HVAC and boiler property) is instead eligible for a 30% credit. The $500 lifetime cap (and the $200 lifetime cap for windows) is eliminated and replaced with an aggregate cap of $1,500 for property placed in service between 2009 and 2011. The Act also eliminates the dollar limits on residential small wind energy property, solar water heating and geothermal pumps.

Alternative Fuel Refueling Station Credit - The Act increases, for property placed in service after December 31, 2008 and before 2011, the maximum credit available for qualified hydrogen refueling property (from $30,000 to $200,000) as well as the maximum credit available for other non-hydrogen related qualified refueling property (from $30,000 to $50,000, with the credit rate being increased to 50% of the cost of non-hydrogen related qualified refueling property). In addition, the maximum credit is increased from $1,000 to $2,000 for alternative fuel refueling property installed at a principal residence.

Vehicles - The Act provides a credit of $2,500 to $7,500 for the purchase of plug-in electric vehicles (the amount of the credit varies depending on the vehicle's range). Credits for conversion kits to electric power are available as well.

Bond Financing - The Act authorizes the issuance of up to an additional $1.6 billion (up from a national maximum of $800 million) of new clean renewable energy bonds which may be issued to finance renewable energy facilities - - those facilities which qualify for the tax credits set forth above (without regard to its in-service date requirements) and are owned by a public power provider, governmental body, or cooperative electric company.

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Because of these expansive changes to the tax code, individuals and business should be sure to look for significant tax planning opportunities that may now be available. If you have any questions, please feel free to contact Gordon Moore, who chairs our Tax Group, at (856) 354-3087, or gmoore@archerlaw.com.