TAX BENEFITS IN THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009

2009

The widely publicized American Recovery and Reinvestment Act of 2009 (the "Act") was signed into law by President Obama on February 17, 2009. The debate over the contents of this Act has left many wondering exactly what benefits it provides, and who is eligible for the benefits. Many of the benefits are provided through changes or additions to the federal tax laws. Below is a summary of the tax provisions of general interest contained in the Act.

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Relief for Individuals

Making Work Pay Credit

Congress enacted President Obama's proposal for a refundable individual income tax credit in the amount of 6.2% of earned income, not to exceed $400 for a single taxpayer ($800 for joint filers). The credit begins to phase-out for single taxpayers making more than $75,000 ($150,000 for joint filers) and completely phases-out for those making at least $95,000 ($190,000 for joint filers). For taxpayers making $75,000 ($150,000 for joint filers) or less, the credit, effectively, offsets an individual's share of FICA payroll taxes for the first $6,450 ($12,900 for joint filers) in earnings. The credit is available for the December 31, 2009 and 2010 tax years. Nonresident aliens and those who are claimed as a dependent on another's income tax return are excluded from the credit entirely. Although it is unclear exactly how the IRS will implement this credit, it is likely that taxpayers will receive this benefit through a reduction in the amount of tax that is withheld from their paychecks, or by claiming the credit on their tax returns.

American Opportunity Tax Credit (formerly known as the Hope Scholarship Credit)

The Act expands the Hope Scholarship Credit (renamed the "American Opportunity Tax Credit") available to college students (and those who support them in certain instances) in amount, phase-out level, and scope. The amount of the annual credit increases from a maximum of $1,800 in 2008 to a maximum of $2,500 for 2009 and 2010. The credit now begins to phase-out for individual taxpayers making more than $80,000 ($160,000 for joint filers), whereas the phase-out under prior law began at $50,000 ($100,000 for joint filers). 40% of the credit is refundable. Also, textbooks are now expenses for which the credit is available. In addition, the credit is now available for the first four years of college, instead of only the first two.

First-time Homebuyer Tax Credit

Congress extended and increased the "first-time" homebuyer tax credit. The credit is 10% of the purchase price, up to a maximum of $8,000 (up from the $7,500 maximum under prior law). The enhancements to the credit also include the elimination of any payback requirement if the taxpayer holds the residence for at least 3 years. These enhancements to the credit apply to homes purchased after December 31, 2008 and before December 1, 2009. Purchases made prior to January 1, 2009 continue to be governed by the original first-time homebuyer credit enacted in 2008. The credit phases out for taxpayers with adjusted gross income in excess of $75,000 ($150,000 for joint filers) regardless of whether the purchase occurred in 2008 or 2009.

Above-the-line Deduction for Sales Tax on Automobile Purchases

The Act provides all taxpayers with a deduction for state or local sales or excise tax paid on the first $49,500 of the purchase price of domestic or foreign passenger automobiles, light trucks, recreational vehicles, and motorcycles. The deduction does not apply to sales taxes paid on a lease agreement. The deduction is subject to a phase-out for taxpayers with adjusted gross income in excess of $125,000 ($250,000 for joint filers). The deduction is allowed in computing alternative minimum taxable income. Taxpayers who do not itemize their deductions are nonetheless eligible for this deduction. The deduction is available only for purchases made after February 17, 2009 and before January 1, 2010.

Extension of AMT relief for 2009

The Act extends relief from the Alternative Minimum Tax (AMT) through 2009 by increasing the 2009 exemption level to $46,700 for single taxpayers and $70,950 for joint filers. In addition, the Act extends the provision allowing nonrefundable personal credits to continue to offset the AMT for 2009.

Other provision affecting individuals

- A one-time payment of $250 to retirees, disabled persons and SSI recipients receiving benefits from the Social Security Administration, Railroad Retirement beneficiaries, and disabled veterans receiving benefits from the U.S. Department of Veterans Affairs. This one-time payment is a reduction to any allowable Making Work Pay Credit.
- A temporary increase in the earned income tax credit (from 40% to 45%) for working families with three or more children.
- An increase in the eligibility for the refundable child tax credit in 2009 and 2010 by lowering the threshold amount of income that must be earned before the credit becomes refundable to $3,000.
- Temporary suspension (for 2009 only) of taxation of the first $2,400 of unemployment benefits received.

<u>**Benefits to Businesses**</u>

Extension of Bonus Depreciation

The Act extends the provision that allows businesses to recover the costs of capital expenditures faster than ordinary depreciation would by permitting these businesses to immediately write-off 50% of the cost of depreciable property (e.g., equipment, computers) acquired in 2009 for use in the U.S. The Act also extends (through 2009) the provision that allows businesses to accelerate the recognition of a portion of their historic AMT or research and development (R&D) credits in lieu of bonus depreciation.

Extension of Increase in Small Business Expensing Limits

To help small businesses quickly recover the cost of certain capital expenses, small businesses can elect to write-off the cost of those expenses in the year they are acquired instead of recovering the costs over time through depreciation. This is available on new or used property. In 2008, Congress voted to increase the amount that small businesses can write-off to $250,000 and increase the phase-out threshold to $800,000. The Act extends those 2008 increases to capital expenditures incurred in 2009.

5-Year Carryback of Net Operating Losses of Small Businesses

Small businesses with gross receipts of $15 million or less can elect to carry net operating losses incurred in a tax year beginning or ending in 2008 back to 2003, 2004, 2005, 2006, or 2007. Under prior law, such losses could have been carried back only to 2006 or 2007.

Delayed Recognition of Certain Cancellation of Debt Income

The Act adds a new provision that allows certain businesses to recognize cancellation of debt income on the repurchase of specified types of business debt over 10 years by deferring the tax on the income for the first 5 years, if repurchased in 2009, or for the first four years, if repurchased in 2010, and then recognizing the income ratably over the subsequent 5-year period. This provision applies only to qualifying business debt repurchased by the business in 2009 or 2010.

Other changes affecting businesses

- Incentives to hire unemployed veterans and disconnected youth.
- Temporary (for 2009 only) reduction in the estimated tax payments required for certain small businesses.
- Temporary reduction of the built-in gains holding period for certain Subchapter S corporations from 10 to 7 years. This provision applies for sales occurring in 2009 and 2010.
- Increase in the exclusion for individuals on the gain from the sale of certain small business stock held for more than 5 years from 50% to 75%. This change applies to stock issued after February 17, 2009 and before January 1, 2011.

In addition to the provisions listed above, the Act also contains several energy tax provisions aimed at expanding the development and production of alternative sources of energy. There are also provisions in the Act designed to provide fiscal relief for states by preventing cuts in health care, education, law enforcement, and other programs, avoiding tax increases, and increasing spending on infrastructure improvements.